CAPITAL ONE FINANCIAL CORP
Form 10-K
February 26, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the fiscal year ended December 31, 2008.

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED).**
For the transition period from to

Commission File No. 1-13300

CAPITAL ONE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**54-1719854**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
1680 Capital One Drive	
McLean, Virginia	**22102**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: (703) 720-1000

Securities registered pursuant to section 12(b) of the act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Common Stock, $.01 Par Value	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) Yes ¨ No x

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the close of business on June 30, 2008.

Common Stock, $.01 Par Value: $14,119,470,287*

* In determining this figure, the registrant assumed that the executive officers of the registrant and the registrant s directors are affiliates of the registrant. Such assumption shall not be deemed to be conclusive for any other purpose. The number of shares outstanding of the registrant s common stock as of the close of business on January 31, 2009.

Common Stock, $.01 Par Value: 391,827,184 shares

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of the Proxy Statement for the annual meeting of stockholders to be held on April 24, 2009 are incorporated by reference into Part III.

Table of Contents

CAPITAL ONE FINANCIAL CORPORATION

2008 ANNUAL REPORT ON FORM 10-K

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. *Business.*

Overview

Capital One Financial Corporation (the Corporation) is one of the largest banks in the United States, incorporated in Delaware on July 21, 1994, whose banking and non-banking subsidiaries market a variety of financial products and services. The Corporation s principal subsidiaries include Capital One Bank (USA), National Association (COBNA) which currently offers credit and debit card products, other lending products, and deposit products; and Capital One, National Association (CONA) which offers a broad spectrum of banking products and financial services to consumers, small businesses and commercial clients. The Corporation and its subsidiaries are collectively referred to as the Company. Unless indicated otherwise, the terms Corporation , we , us , and our refer to the Corporation and its consolidated subsidiaries.

As of December 31, 2008, we had $108.6 billion in deposits and $146.9 billion in managed loans outstanding. We are the 4th largest issuer of Visa® (Visa) and MasterCard® (MasterCard) credit cards in the United States based on managed credit card loans outstanding, and we are the 10th largest depository institution in the United States.

We offer our products throughout the United States. We also offer our products outside of the United States principally through Capital One Bank (Europe) plc, an indirect subsidiary of COBNA organized and located in the United Kingdom (the U.K. Bank), and through a branch of COBNA in Canada. Our U.K. Bank has authority, among other things, to accept deposits and provide credit card and installment loans. Our branch of COBNA in Canada has the authority to provide credit card loans.

Our common stock is listed on the New York Stock Exchange under the symbol COF and as of January 31, 2009, the Company s common stock was held by 17,653 shareholders. Our principal executive office is located at 1680 Capital One Drive, McLean, Virginia 22102 (telephone number (703) 720-1000). The Corporation maintains a website at *www.capitalone.com*. Documents available on our website include (i) Codes of Business Conduct and Ethics for the Corporation; (ii) the Corporation s Corporate Governance Principles; and (iii) charters for the Audit and Risk, Compensation, Finance and Trust Oversight, and Governance and Nominating Committees of the Board of Directors. These documents are also available in print to any shareholder who requests a copy. In addition, we make available free of charge through our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after electronic filing or furnishing of such material to the SEC.

Business Description

Capital One is one of the largest banks in the United States. We are a diversified banking corporation focused primarily on consumer and commercial lending and deposit origination. Our principal business segments are Local Banking and National Lending. Local Banking includes the Company s branch, treasury services and national deposit gathering activities; its commercial, branch based small business lending and certain branch originated consumer lending; and its mortgage servicing activities. The National Lending segment consists of two sub-segments: the U.S. Card sub-segment which consists of domestic consumer credit and debit card activities, and; the Other National Lending sub-segment which includes the Company s auto finance and international lending sub-segments. For further discussion of our segments, see Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Reportable Segment Summary and Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 3.

Local Banking Segment. The Local Banking segment offers traditional banking products through an extensive branch network in Connecticut, Louisiana, New Jersey, New York, and Texas. Products include commercial and consumer loans, commercial and consumer deposit account services, commercial credit cards, treasury management services, trust services and other banking related products, such as insurance, brokerage services, merchant services, and investment banking. In addition, the Local Banking segment offers money market (liquid accounts) and certificate of deposit accounts (time deposits) through internet channels.

U.S. Card Sub-segment. The U.S. Card sub-segment offers a wide variety of credit card and small business products, in addition to unsecured closed-end loans throughout the United States, which we customize to appeal to different consumer preferences and needs. Our product offerings are supported by extensive brand advertising. We routinely test new products to develop products that appeal to different and changing consumer preferences. Our customized products include products offered to a wide range of consumer credit risk profiles, as well as products aimed at special consumer interests.

Other National Lending Sub-segment. The Other National Lending sub-segment includes the Auto Finance sub-segment and International sub-segment.

Auto Finance Sub-segment. In the Auto Finance sub-segment, we purchase retail installment contracts, secured by new and used automobiles or other motor vehicles, through dealer networks throughout the United States. Additionally, we utilize direct marketing, including the internet, to offer automobile financing directly to consumers for the purchase of new and used vehicles, as well as refinancing of existing motor vehicle loans. As of December 31, 2008, we are the fourth largest non-captive provider of auto financing in the United States.

Table of Contents

International Sub-segment. The International sub-segment consists of U.K. and Canada credit card lending, extending Capital One s national scale lending franchise and providing geographic diversification. In our international sub-segment, we utilize methodologies and approaches similar to those we use in the U.S. Card sub-segment, offering customized credit card products across the consumer risk spectrum.

Chevy Chase Bank Acquisition

On December 4, 2008, the Company announced its intention to acquire Chevy Chase Bank F.S.B., the largest retail depository institution in the Washington, D.C. region in a cash and stock transaction valued at approximately $520 million. On February 13, 2009, the Company received approval from the Federal Reserve to acquire all of the shares of Chevy Chase Bank F.S.B. and certain of its subsidiaries. The Company expects the transaction to close in the first quarter of 2009.

Geographic Diversity

Loan portfolio concentration within a specific geographic region may be regarded differently based upon the current and expected credit characteristics and performance of the portfolio. Our loan portfolio is geographically diverse, although we do have commercial lending concentrations in the New York metropolitan area and Louisiana. See Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 22 of this form.

Enterprise Risk Management

Capital One s policy is to identify, assess, and mitigate risks that affect or have the potential to affect our business, to target financial returns commensurate with the Company s risk appetite, and to avoid excessive risk-taking. We follow three key principles related to this policy.

1. Individual businesses take and manage risk in pursuit of strategic, financial, and other business objectives

2. Independent risk management organizations support individual businesses by providing risk management tools and policies, and by aggregating risks; in some cases, risks are managed centrally

3. The Board of Directors and top management review our aggregate risk position and establish the risk appetite

Our approach is reflected in four critical risk management practices of particular importance in today s environment.

First, we recognize liquidity risk as among the critical risks facing financial institutions today. We seek to mitigate this risk strategically and tactically. From a strategic perspective, we have acquired and built deposit gathering businesses and significantly reduced our loan to deposit ratio. From a tactical perspective, we have accumulated a very large liquidity reserve comprising cash, high-quality, unencumbered securities, and committed collateralized credit lines and conduit facilities.

Second, we recognize that credit issues are a frequent cause of financial institution stress and that we are exposed to cyclical changes in credit quality. Consequently, we try to ensure our credit portfolio is resilient to economic downturns. Our most important tool is conservative underwriting. In consumer underwriting, we try to anticipate recession and base our underwriting decisions on models that include economic assumptions at least as conservative as our financial planning assumptions. In commercial underwriting, we insist on strong cash flow, strong collateral, and strong covenants and guarantees. In addition to conservative underwriting, we aggressively monitor our portfolio and aggressively collect or work out troubled loans. In our mortgage portfolio, in addition to standard collection techniques, we modify loans, including principal forbearance, where appropriate, consistent with the general guidelines in Fannie Mae s and Freddie Mac s programs.

Third, we recognize that reputational risk is of particular concern in today s turbulent environment. Consequently, our CEO and executive team manage both tactical and strategic reputation issues and manage our relationships with the government, media, and other constituencies to help strengthen the reputations of both Capital One and our industry. This includes taking public positions in support of better consumer practices in our industry and, where possible, unilaterally implementing those practices in our business.

Finally, we recognize that maintaining appropriate capital levels is a particular concern in today s environment. In September, we raised $760.8 million of new common equity to provide insurance that would be able to seize new opportunities as they arose and to protect our capital position from the potential for unanticipated credit deterioration. In October, we agreed to issue $3.5 billion of preferred stock and warrants to the U.S. Treasury under the Capital Purchase Program to protect against any potential risks to our regulatory capital ratios. We plan and manage our balance sheet, lending and investment activities to conform to our views regarding capital sufficiency. Ensuring that we have sufficient capital is one of the core functions of our Finance Department, Executive Committee, ALCO Committee, Finance Committee of the Board and our full Board of Directors. See Section X. Capital for further discussion regarding capital.

Risk Management Roles and Responsibilities

The Board of Directors is responsible for:

- establishing Capital One s overall risk framework;
- authorizing, approving, and overseeing execution of the Enterprise Risk Management Policy; and
- reviewing Capital One s risk profile and establishing the overall risk appetite.

The Chief Executive Officer is responsible for:

- managing the company s overall risk position;
- appointing the Chief Risk Officer, subject to the Board s approval;

4

Table of Contents

appointing executives to the Risk Management Committee, in coordination with the Chief Risk Officer; and

selecting Risk Stewards for each risk category based on subject matter expertise and organizational authority.

The Division Presidents are responsible for:

identifying risks and implementing appropriate risk controls when pursuing their business strategies and objectives;

ensuring their businesses operate within the corporate risk appetite and comply with policies and procedures established by the Risk Stewards;

considering risk when developing strategic plans, budgets, and new products, including mitigating risk when necessary;

producing risk reporting that is relevant, sufficient, accurate and timely; and

designating Business Chief Risk Officers for their respective divisions.

The Chief Risk Officer is responsible for:

assessing the quality of Capital One s risk management program and driving appropriate action to resolve gaps in the risk management program or in risk mitigation;

establishing and implementing Capital One s overall Enterprise Risk Management Policy;

overseeing the overall Enterprise Risk Management Program;

chairing the Risk Management Committee;

appointing the Enterprise Risk Management Executive; and

aggregating risks and reporting Capital One s risk profile to the Board of Directors.

The Enterprise Risk Management Executive is responsible for:

providing frameworks, tools and methods to identify and manage risk;

monitoring adherence with the Enterprise Risk Management Policy;

- analyzing, aggregating, and recommending risks for top risk designation;
- managing processes and providing tools for identification, aggregation and mitigation of risks across all risk categories; and
- managing risk related to horizontal functions on behalf of the entire company.

Risk Stewards are responsible for:

- continually monitoring the effectiveness of risk management processes for their risk category;
- setting direction and establishing risk limits (i.e. risk appetite) for their risk category consistent with the risk appetite established by the Board;
- identifying when a business area is operating outside of established risk limits and driving corrective action.

Each Business Chief Risk Officer is responsible for the following in his/her business division:

- assessing the quality of the division s risk management program and driving to resolve gaps in the risk management program or in risk mitigation;
- creating and maintaining a risk management culture;
- executing a comprehensive risk management strategy;
- leading regular, actionable risk self-assessments that are reviewed with their Division President and the Enterprise Risk Management Executive;
- ensuring proper controls are in place and that such controls are properly executed;
- ensuring risk monitoring and data are proper, comprehensive, and accurate; and
- executing an information and communication strategy that supports the risk culture and key risk management objectives.

Risk Management Committees

Capital One maintains the following three top level risk committees, each with appropriate sub-committees as indicated:

1. Asset/Liability Management Committee: oversees rate risk, market risk, capital adequacy, and the investment portfolio

Balance Sheet Risk Management Committee

2. Credit Policy Committee: oversees the corporate credit portfolio and enterprise-wide credit program and policies

Divisional Credit Committees for each major product segment

3. Risk Management Committee: oversees the enterprise risk policy and program with a focus on overall/aggregate risks

Compliance Committee

Operational Risk Committee

Risk Management and Control Framework

Capital One uses a consistent framework to manage risk. The framework applies at all levels, from the development of the Enterprise Risk Management Program itself to the tactical operations of the front-line business team. The framework has six key elements:

1. Objective Setting;

Table of Contents

2. Risk Assessment;

3. Control Activities;

4. Communication and Information;

5. Program Monitoring; and

6. Organization and Culture.

Objective Setting is at the beginning of our risk management approach. We set strategic, financial, operational, and other objectives during our strategic and annual planning processes and throughout the year. These objectives cascade through the organization to individual teams of associates.

Risk Assessment is the process of identifying risks to our objectives, evaluating the impact of those risks and choosing a response. Responses include avoidance, mitigation, or acceptance. Risk responses are guided by our established risk appetite. In certain risk categories, risk assessment is largely conducted by central risk groups or jointly between business areas and central groups (market, liquidity, legal, credit, compliance). In other risk categories, risk assessment is primarily the responsibility of business areas with more limited central support (strategic, operational, reputation).

Control Activities are the day-to-day backbone of our Enterprise Risk Management Program. Controls provide reasonable assurance that legal, regulatory, and business requirements are met, and identified risks are being mitigated, avoided, or accepted according to our risk appetite. We have practices in place to ensure key controls are established, evaluated, and effective in preventing a breakdown. Control activities include the monitoring of adherence to current requirements, regular reporting to management, and regular reviews and sign-offs. They also include the resolution of regulatory and audit findings and issues and the procedures that trigger objective setting and risk assessments when new business opportunities are evaluated or business hierarchy changes occur.

Communication and Information must provide a solid infrastructure to support the objective setting, risk assessment, and control activities described above. We have established policies for each risk category which define the specific reports to be used and the communication infrastructure. Robust risk management requires well-functioning communication channels to inform associates of their responsibilities, alert them to issues or changes that might affect their activities, and to enable an open flow of information up, down, and across the company.

Program Monitoring is critical to the Enterprise Risk Management Program itself because it assesses the accuracy, sufficiency, and effectiveness of current objectives, risk assessments, controls, ownership, communication, and management support. Where deficiencies are discovered, the Enterprise Risk Management Program must be updated to resolve the deficiencies in a timely manner. Clear accountability must also be defined when resolving deficiencies to ensure the desired outcome is achieved. Risk management programs are monitored at every level; from the overall Enterprise Risk Management Program to the individual risk management activities in each business area.

Our ***Organization and Culture*** promote risk management as a key factor in making important business decisions. An effective risk management culture starts with a well-defined risk management philosophy. It requires established risk management objectives that align to business objectives and make targeted risk management activities part of ongoing business management activities.

We have a corporate Code of Business Conduct and Ethics (the Code) (available on the Corporate Governance page of our website at www.capitalone.com/about) under which each associate is obligated to behave with integrity in dealing with customers and business partners and to comply with applicable laws and regulations. We disclose any waivers to the Code on our website. Currently, there are no waivers. We also have an associate performance management process that emphasizes achieving business results while ensuring integrity, compliance, and sound business management. Our risk management culture is also encouraged through frequent direction and communications from the Board of Directors, senior leadership, corporate and departmental risk management policies, risk management and compliance training programs and on-going risk assessment activities in the business areas.

Risk Appetite

Capital One organizes its Enterprise Risk Management Program around eight risk categories. The risk categories enable us to efficiently aggregate risks, provide a mechanism to discuss risk appetite, and facilitate the assignment of expert risk resources to support our business activities. While we customize specific risk objectives and control methodologies to each risk category, they share, at the highest level, a common approach to describing and measuring risk appetite.

Risk appetites are approved by the Board of Directors and are used both to monitor the company s evolving risk position and to guide strategic and tactical decision making. The risk appetite framework assesses each risk category across the following three dimensions:

1. Net Risk: Assessment of the level of risk given internal and external factors;

2. Quality of Governance and Controls: Evidence demonstrating the strength (or weakness) of our risk governance structure and/or controls associated with the risk category and our ability to address issues; and

3. Mitigation Plan Status: When needed, the status of key mitigation activity needed to reduce risk.

Table of Contents

Risk Categories

Capital One s risk management program is organized around eight risk categories. They are:

1. Liquidity
2. Credit
3. Reputation
4. Market
5. Strategic
6. Operational
7. Compliance
8. Legal

Following are descriptions of our approach to each risk category.

Liquidity Risk is the risk that future financial obligations are not met or future asset growth cannot occur because of an inability to obtain funds at a reasonable price within a reasonable time.

The Chief Financial Officer is the accountable executive for liquidity risk and serves as the Risk Steward.

Liquidity strength is assessed through balance sheet metrics, and stress testing is used to ensure that Capital One can withstand significant degradation in the funding markets (particularly in the wholesale funding markets). We regularly evaluate our liquidity position under various liquidity stress scenarios with the Asset/Liability Management Committee and Finance Committee, providing recommendations for any necessary actions to ensure our liquidity risk exposure is well managed. Management reports liquidity metrics to the Finance Committee no less than quarterly. Breaches in liquidity policy limits are reported to the Treasurer as soon as they are identified and to the Asset/Liability Management Committee at the next regularly scheduled committee meeting, unless said breach activates the Liquidity Contingency Plan. Breaches are also reported to the Finance Committee no later than the next regularly scheduled meeting. Detailed processes, requirements and controls are contained in our policies and supporting procedures.

Credit Risk is the risk of loss from a borrower s failure to meet the terms of any contract or failure to otherwise perform as agreed. There are four primary sources of credit risk: (1) changing economic conditions, which affect borrowers ability to pay and the value of any collateral; (2) a changing competitive environment, which affects customer debt loads, borrowing patterns and loan terms; (3) our underwriting strategies and standards, which determine to whom we offer credit and on what terms; and (4) the quality of our internal controls, which establish a process to test that underwriting conforms to our standards and identifies credit quality issues so we can act upon them in a timely manner.

The Chief Risk Officer is the accountable executive for credit risk and serves as the Risk Steward. Responsibility for consumer credit risk is delegated to the Chief Consumer Credit Officer and responsibility for commercial credit risk is delegated to the Chief Commercial Credit Officer.

We have quantitative credit risk guidelines for each of our lines of business. We conduct portfolio and decision level monitoring and stress tests using economic and legislative stress scenarios. Credit risk objectives are achieved by establishing a credit governance framework and by establishing policies, procedures, and controls for each step in the credit process. The Board, Chief Executive Officer, Chief Risk Officer, Chief Consumer and Commercial Credit Officers, and Division Presidents have specific accountable roles in the management of credit risk. These include policy approval, creation of credit strategy, review of credit position, and delegation of authority. Our evolving credit risk position and recommendations to address issues are reviewed by the Credit Policy Committee and the Board of Directors.

Reputation Risk is the risk to market value, recruitment, and retention of talented associates and a loyal customer base due to the negative perceptions of Capital One s internal and external stakeholders regarding Capital One s business strategies and activities.

The Company s General Counsel is the accountable executive for reputation risk and the Corporate Affairs Executive is the Risk Steward on behalf of the General Counsel.

Reputation risk is managed and owned by business areas in accordance with our Reputation Risk Policy. The Corporate Affairs Executive assists business areas in evaluating the reputation risk of new and existing business activities. Each Division President is responsible for highlighting potential reputational issues and executing appropriate risk mitigation activities. The Corporate Affairs Executive is responsible for assessing and reporting our aggregate reputation risk, as well as the state of Capital One s reputation with specific stakeholder groups, to the General Counsel, Chief Risk Officer, and Risk Management Committee.

Table of Contents

Market Risk is the risk that earnings or the economic value of equity will under-perform due to changes in interest rates, foreign exchange rates (market rates), or other financial market asset prices. Our ability to manage market risks contributes to our overall capital management.

The Chief Financial Officer is the accountable executive for market risk and serves as the Risk Steward.

The market risk positions of Capital One s banking entities and the consolidated Company are calculated separately and in total, are compared to the pre-established limits, and are reported to the Asset/Liability Management Committee and Finance Committee no less than quarterly. Management is authorized to utilize financial instruments to actively manage market risk exposure. Detailed processes, requirements and controls are contained in our policies and supporting procedures.

Strategic Risk is the risk that Capital One fails to achieve short and long-term business objectives because we fail to develop the products, capabilities, and competitive position necessary to attract consumers, compete with competitors and withstand market volatility. The result is a failure to deliver returns expected by stakeholders (customers, associates, shareholders, investors, communities, and regulators).

The Chief Executive Officer is the accountable executive for Capital One strategy. The Strategy Executive serves as the Risk Steward for strategy risk identification, aggregation, and mitigation on behalf of the Chief Executive Officer.

The Chief Executive Officer, together with the strategy executive, develops an overall corporate strategy and leads alignment of the entire organization with this strategy through definition of strategic imperatives and top-down communication. The Chief Executive Officer and other senior executives spend significant time throughout the entire company sharing the company s strategic imperatives to promote an understanding of our strategy and connect it to day-to-day associate activities to enable effective execution. Division Presidents are accountable for defining business strategy within the context of the overall corporate level strategy and Strategic Imperatives. Division Presidents review their strategies with the strategy group to assess strategy viability and identify and mitigate risks. Business strategies are integrated into the Corporate Strategic Plan and are reviewed and approved separately and together on an annual basis by the Chief Executive Officer and Board of Directors.

Operational Risk is the risk of direct or indirect financial loss from failed or inadequate processes, associate capabilities or systems, or exposure to external events. The risk of financial loss associated with litigation is also included under operational risk.

The Chief Risk Officer is the accountable executive for establishment of risk management standards and for governance and monitoring of operational risk at a corporate level. Division Presidents have primary accountability for management of operational risk within their business areas. The Operational Risk Management Executive is the Risk Steward for operational risk.

While most operational risks are managed and controlled by business areas, the Operational Risk Management Program establishes requirements and control processes that assure certain consistent practices in the management of operational risk, and provides transparency to the corporate operational risk profile. Our Operational Risk Management Program also includes two primary additional functions. Operational Risk Reporting involves independent assessments of the control and sustainability of key business processes at a corporate and business area level, and such assessments are provided to the Chief Risk Officer, Risk Management Committee, and Audit and Risk Committee. The Operational Risk Capital function, in conjunction with the corporate capital process managed by Global Finance, establishes necessary operational risk capital levels to assure resiliency against extreme operational risk event scenarios.

Operational Risk results and trends are reported to the Risk Management Committee and the Audit and Risk Committee of the Board.

Compliance Risk is the risk of financial loss due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action as a result of failing to adhere to applicable laws, regulations, and supervisory guidance.

Division Presidents are the accountable executives for compliance risk and are responsible for building and maintaining compliance processes and providing required reporting to the Risk Steward. With the Chief Compliance Officer, Division Presidents are jointly accountable for ensuring the Compliance Management Program requirements are met for their division. The Chief Compliance Officer is the Risk Steward.

We ensure compliance by maintaining an effective Compliance Management Program consisting of sound policies, systems, processes, and reports. The Compliance Management Program provides management with guidance, training, and monitoring to provide reasonable assurance of our compliance with internal and external compliance requirements. Additionally, management and

the Corporate Compliance department jointly and separately conduct on-going monitoring and assess the state of compliance. The assessment provides the basis for performance reporting to management and the Board, allows business areas to determine if their compliance performance is acceptable, and confirms effective compliance controls are in place. Business areas embed compliance requirements and controls into their business policies, standards, processes and procedures. They regularly monitor and report on the efficiency of their compliance controls. Corporate Compliance, jointly working with the business, defines and validates a standard compliance monitoring and reporting methodology. Compliance results and trends are reported to the Risk Management Committee and the Audit and Risk Committee of the Board.

Legal Risk is the risk of material adverse impact due to: (i) new and changed laws and regulations; (ii) new interpretations of law; (iii) the drafting, interpretation and enforceability of contracts; (iv) adverse decisions or consequences arising from litigation or regulatory scrutiny; (v) the establishment, management and governance of our legal entity structure; and (vi) the failure to seek or follow appropriate Legal counsel when needed.

The company s General Counsel is the accountable executive for monitoring and controlling legal risk and serves as the Risk Steward.

The Legal department serves as our control against legal risk by providing legal evaluation and guidance. This evaluation and guidance is based on the assessment of Legal counsel as to the type and degree of legal risk associated with internal business area practices and activities, and of the controls the business has in place to mitigate legal risk. When Legal becomes aware of any risk that falls outside of acceptable risk assessment limits, there is an internal escalation process to ensure appropriate executives are made aware of that risk in a timely manner. In addition, we holistically review our legal risk position each quarter with the Legal Risk Steward, other senior executives, and the Audit and Risk Committee of the Board of Directors.

Technology / Systems

We leverage information technology to achieve our business objectives and to develop and deliver products and services that satisfy our customers needs. A key part of our strategic focus is the development of efficient, flexible computer and operational systems to support complex marketing and account management strategies and the development of new and diversified products. Our commitment to managing risk and ensuring effective controls is built into all of our strategies. We believe that the continued development and integration of these systems is an important part of our efforts to reduce costs, improve quality and provide faster, more flexible technology services. Consequently, we continuously review capabilities and develop or obtain systems, processes and competencies to meet our unique business requirements.

As part of our continuous efforts to review and improve our technologies, we may either develop such capabilities internally or rely on third party outsourcers who have the ability to deliver technology that is of higher quality, lower cost, or both. Over time, we have increasingly relied on third party outsourcers to help us deliver systems and operational infrastructure. These relationships include (but are not limited to): Total System Services Inc. (TSYS) for processing services for Capital One s North American and United Kingdom portfolios of consumer and small business credit card accounts, Fidelity National Information Services (Fidelity) for the Capital One banking systems, and IBM Corporation for management of our North American data centers. In the first quarter of 2008, we migrated our United Kingdom credit card portfolio to the European version of the TSYS processing platform.

During the first half of 2008, we completed the conversion of the legacy North Fork banking systems to a single platform hosted by Fidelity. We are in the initial stages of assessing the potential impact of the proposed Chevy Chase Bank F.S.B., acquisition on our systems and technology. We expect the Chevy Chase Bank F.S.B. acquisition to close in the first quarter of 2009 and we expect to complete integration planning in mid-2009 and to begin the subsequent migrations later in the year.

Funding and Liquidity

A discussion of our funding programs and liquidity has been included in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Funding.

Competition

As a diversified bank that markets credit cards and consumer and commercial financial products and services, we face intense competition in all aspects of our business from numerous bank and non-bank providers of financial services.

We compete with national and state banks for deposits, commercial loans and trust accounts and with savings and loan associations and credit unions for loans and deposits. We also compete with other financial services providers for loans, deposits, and other services and products. In addition, we compete against non-depository institutions that are able to offer products and services that were typically banking products and services. In general, in the current economic environment, customers are attracted to depository institutions that are perceived as stable, with solid liquidity and funding.

Table of Contents

We compete with international, national, regional and local issuers of Visa® and MasterCard® credit cards, as well as with American Express®, Discover Card® and, to a certain extent, debit cards. In general, customers are attracted to credit card issuers largely on the basis of price, credit limit and other product features, and customer loyalty is often limited.

In motor vehicle finance, we face competition from banks and non-bank lenders who provide financing for dealer-originated loans.

We believe that we are able to compete effectively in our current markets. There can be no assurance, however, that our ability to market products and services successfully or to obtain adequate returns on our products and services will not be impacted by the nature of the competition that now exists or may later develop, or by the broader economic environment. For a discussion of the risks related to our competitive environment, please refer to Item 1A. Risk Factors We Face Intense Competition in All of Our Markets.

Intellectual Property

As part of our overall and ongoing strategy to protect and enhance our intellectual property, we rely on a variety of protections, including copyrights, trademarks, trade secrets, patents and certain restrictions on disclosure and competition. We also undertake other measures to control access to and distribution of our other proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use certain intellectual property or proprietary information without authorization. Our precautions may not prevent misappropriation or infringement of our intellectual property or proprietary information. In addition, our competitors also file patent applications for innovations that are used in our industry. The ability of our competitors to obtain such patents may adversely affect our ability to compete. Conversely, our ability to obtain such patents may increase our competitive advantage. There can be no assurance that we will be successful in such efforts, or that the ability of our competitors to obtain such patents may not adversely impact our financial results.

Employees

As of December 31, 2008, we employed approximately 25,800 employees whom we refer to as associates. A central part of our philosophy is to attract and maintain a highly capable staff. We view current associate relations to be satisfactory. None of our associates is covered under a collective bargaining agreement.

Supervision and Regulation

General

The Company is a bank holding company (BHC) under Section 3 of the Bank Holding Company Act of 1956, as amended (the BHC Act) (12 U.S.C. § 1842). The Company is subject to the requirements of the BHC Act, including its capital adequacy standards and limitations on the Company s nonbanking activities, and to supervision, examination and regulation by the Federal Reserve Board (the Federal Reserve). Permissible activities for a BHC include those activities that are so closely related to banking as to be a proper incident thereto such as consumer lending and other activities that have been approved by the Federal Reserve by regulation or order. Certain servicing activities are also permissible for a BHC if conducted for or on behalf of the BHC or any of its affiliates. Impermissible activities for BHCs include activities that are related to commerce such as retail sales of nonfinancial products. Under Federal Reserve policy, the Corporation is expected to act as a source of financial and managerial strength to any banks that it controls, including COBNA and CONA (the Banks), and to commit resources to support them.

On May 27, 2005, the Company became a financial holding company under the Gramm-Leach-Bliley Act amendments to the BHC Act (the GLBA). The GLBA removed many of the restrictions on the activities of BHCs that become financial holding companies. A financial holding company, and the non-bank companies under its control, are permitted to engage in activities considered financial in nature (including, for example, insurance underwriting, agency sales and brokerage, securities underwriting, dealing and brokerage and merchant banking activities); incidental to financial activities; or complementary to financial activities if the Federal Reserve determines that they pose no risk to the safety or soundness of depository institutions or the financial system in general.

The Company s election to become a financial holding company under the GLBA certifies that the depository institutions the Company controls meet certain criteria, including capital, management and Community Reinvestment Act (CRA) requirements. If the Company were to fail to continue to meet the criteria for financial holding company status, it could, depending on which requirements it failed to meet, face restrictions on new financial activities or acquisitions and/or be required to discontinue existing activities that are not generally permissible for bank holding companies.

COBNA and CONA are national associations chartered under the laws of the United States, the deposits of which are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (the FDIC) up to applicable limits. In addition to regulatory requirements imposed as a result of COBNA s international operations (discussed below), COBNA and CONA are subject to comprehensive regulation and periodic examination by the OCC and the FDIC.

On January 1, 2008, Capital One Auto Finance, Inc. (COAF), which engages in automobile financing activities, became a wholly owned subsidiary of CONA. In connection with the COAF reorganization, which included the transfer of approximately $10 billion in assets, the Corporation

Table of Contents

committed to the Federal Reserve to contribute capital to CONA equal to the amount of transferred assets that are or become low-quality assets (as defined in Regulation W) and to hold an amount of risk based capital equal to the book value of low-quality assets. CONA must consider these commitments, in addition to the factors outlined in Dividends and Transfers of Funds below, among other factors when declaring a dividend to the Company.

The Company is also registered as a financial institution holding company under Virginia law and as such is subject to periodic examination by Virginia s Bureau of Financial Institutions. The Company also faces regulation in the international jurisdictions in which it conducts business (see below under International Regulation).

On February 13, 2009, the Company received approval from the Federal Reserve to acquire all the shares of Chevy Chase Bank, F.S.B., and certain of its subsidiaries. Subject to the receipt of all necessary regulatory approvals, the Company expects to merge Chevy Chase Bank, F.S.B., with and into CONA prior to the end of 2009.

Regulation of Business Activities

The activities of the Banks as consumer lenders also are subject to regulation under various federal laws, including the Truth-in-Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act (the FCRA), the Community Reinvestment Act and the Service members Civil Relief Act, as well as under various state laws. Depending on the underlying issue and applicable law, regulators are often authorized to impose penalties for violations of these statutes and, in certain cases, to order the Banks to compensate injured borrowers. Borrowers may also have a private right of action to bring actions for certain violations. Federal bankruptcy and state debtor relief and collection laws also affect the ability of the Banks to collect outstanding balances owed by borrowers. These laws plus state sales finance laws also affect the ability of our automobile financing business to collect outstanding balances.

New Regulations

On December 18, 2008, the Federal Reserve amended Regulation AA to include new rules that would place limitations on certain credit card practices. Among other things, the final rules: (i) impose restrictions on increases in the rate charged on pre-existing credit card balances; (ii) prohibit the use of payment allocation methods that maximize interest charges; (iii) limit the imposition of default annual percentage rates on existing credit card balances; (iv) prohibit the imposition of interest charges using the two-cycle billing method; and (v) require that consumers receive a certain amount of time to make their credit card payments. These rules must be implemented by July 1, 2010. While many of the provisions in the new rules are targeted at practices in which Capital One has not engaged, we anticipate that we will need to make significant changes to current account risk management strategies to address the new limitations these rules impose.

The Federal Reserve also amended Regulation Z on December 18, 2008 to change a number of disclosure and other obligations for credit cards. Among other things, the final rule requires changes to: (i) solicitation and application disclosures; (ii) account opening disclosures; (iii) periodic statements; (iv) disclosures regarding changes in terms; and (v) convenience check disclosures. These rules also must be implemented by July 1, 2010. The amendments will require substantial modifications to virtually all marketing and account management communications.

For a discussion of the risks posed to the Company as a result of these new regulations, please refer to Compliance With New and Existing Laws and Regulations May Increase Our Costs, Limit Our Ability To Pursue Business Opportunities, And Increase Compliance Challenges under Item 1A. Risk Factors.

Dividends and Transfers of Funds

Traditionally dividends to the Company from its direct and indirect subsidiaries have represented a major source of funds for the Company to pay dividends on its stock, make payments on corporate debt securities and meet its other obligations. There are various federal and state law limitations on the extent to which the Banks can finance or otherwise supply funds to the Company through dividends, loans or otherwise. These limitations include minimum regulatory capital requirements, federal and state banking law requirements concerning the payment of dividends out of net profits or surplus, Sections 23A and 23B of the Federal Reserve Act and Regulation W governing transactions between an insured depository institution and its affiliates, and general federal and state regulatory oversight to prevent unsafe or unsound practices. In general, federal and applicable state banking laws prohibit, without first obtaining regulatory approval, insured depository institutions, such as the Banks, from making dividend distributions if such distributions are not paid out of available earnings or would cause the institution to fail to meet applicable capital adequacy standards.

In the current economic environment, however, we expect that the Company may represent a major source of funds for its direct and indirect subsidiaries.

In addition, as a result of our participation in the U.S. Department of Treasury s TARP Capital Purchase Program (CPP), the Company must obtain the U.S. Treasury s consent to increase dividends on its common stock. For additional information about the Company s participation in the CPP, please refer to U.S. Treasury Department s Capital Purchase Program Participation , under

V. Management Summary and Business Outlook, 2008 Summary of Significant Events.

Table of Contents

Capital Adequacy

The Banks are subject to capital adequacy guidelines adopted by federal banking regulators. For a further discussion of the capital adequacy guidelines, see Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Capital Adequacy and Item 8, Financial Statements and Supplementary Data Note 21. The Banks were well capitalized under these guidelines as of December 31, 2008.

Basel II

Implementation of the international accord on revised risk-based capital rules known as Basel II continues to progress in the U.S. Federal banking regulators finalized the Advanced version of Basel II in December 2007 and they issued a Notice of Proposed Rulemaking for the Standardized version in June 2008. Neither version is mandatory for the Company, but the Advanced version could become so due to growth in reported assets. Alternatively, the Company might elect to comply with either the Advanced or Standardized versions of Basel II in the future. Application of the new capital rules could require us to increase the minimum level of capital that we hold. Compliance might also require a material investment of resources. We will continue to closely monitor regulators implementation of the new rules with respect to the large institutions that are subject to it and assess the likely eventual impact to us.

FDICIA

Among other things, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires federal bank regulatory authorities to take prompt corrective action (PCA) with respect to insured depository institutions that do not meet minimum capital requirements. FDICIA establishes five capital ratio levels: well-capitalized, adequately-capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. As of December 31, 2008, each of the Banks met the requirements for a well-capitalized institution. The well-capitalized classification is determined solely for the purposes of applying FDICIA s PCA provisions, as discussed below, and should not be viewed as describing the condition or future prospects of a depository institution, including the Banks. Were any of the Banks to lose their status as well-capitalized they could be required to increase capital or lose access to deposits.

Deposits and Deposit Insurance

Each of the Banks, as an insured depository institution, is a member of the Deposit Insurance Fund (DIF) maintained by the FDIC. Through the DIF, the FDIC insures the deposits of insured depository institutions up to prescribed limits for each depositor. The DIF was formed March 31, 2006, upon the merger of the Bank Insurance Fund and the Savings Association Insurance Fund in accordance with the Federal Deposit Insurance Reform Act of 2005 (the Reform Act). The Reform Act permits the FDIC to set a Designated Reserve Ratio (DRR) for the DIF. To maintain the DIF, member institutions may be assessed an insurance premium and the FDIC may take action to increase insurance premiums if the DRR falls below its required level.

The FDIC has issued rules increasing the assessment rates banks pay for deposit insurance in order to restore the deposit insurance fund. The final rules uniformly raised rates for the first quarter of 2009 by 7 basis points (7 cents for every $100 of deposits), on an annual basis, for all banks. The FDIC also issued proposed rules where future rates would be based on an institution s risk, with riskier institutions bearing a greater share of the proposed increase. Final rules on the risk-based premium assessment are expected in the first quarter of 2009.

The FDIC is also authorized to terminate a bank s deposit insurance upon a finding by the FDIC that the bank s financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the bank s regulatory agency. The termination of deposit insurance for a Bank could have a material adverse effect on its earnings.

The Banks may accept brokered deposits as part of their funding. Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), as discussed in Section X. Capital, only well-capitalized and adequately-capitalized institutions may accept brokered deposits. Adequately-capitalized institutions, however, must first obtain a waiver from the FDIC before accepting brokered deposits, and such deposits may not pay rates that significantly exceed the rates paid on deposits of similar maturity from the institution s normal market area or the national rate on deposits of comparable maturity, as determined by the FDIC, for deposits from outside the institution s normal market area.

FDIC Temporary Liquidity Guarantee Program

On October 14, 2008, the FDIC announced its Temporary Liquidity Guarantee Program (TLGP), which is comprised of the Debt Guarantee Program (DGP) and the Transaction Account Guarantee Program (TAGP).

The TAGP provides unlimited deposit insurance coverage through December 31, 2009, for non-interest bearing transaction accounts (including accounts swept from a non-interest bearing transaction account into a non-interest bearing savings deposit account) and certain interest-bearing accounts (negotiable order of withdrawal (NOW) accounts with interest rates of 0.5 percent or less and lawyers trust accounts) at FDIC-insured depository institutions. Depository institutions participating in the TAGP will be assessed, on a quarterly basis, an annualized 10 basis points fee on the balance of each covered account in excess of the existing FDIC deposit insurance limit of $250,000 that was established on a temporary basis by the Emergency Economic Stabilization Act of 2008.

The DGP provides an FDIC guarantee of certain senior unsecured debt of FDIC-insured institutions and their holding companies. The unsecured debt must be issued on or after October 14, 2008 and not later than October 31, 2009, and the guarantee is effective through the earlier of the maturity date or June 30, 2012. The DGP coverage limit is generally 125% of the eligible entity s eligible debt outstanding on September 30, 2008 and scheduled to mature on or before June 30, 2009 or, for certain insured institutions, 2% of their liabilities as of September 30, 2008. The proceeds of debt guaranteed under the DGP may not be used to prepay debt that is not guaranteed by the FDIC. Depending on the term of the debt maturity, the nonrefundable DGP fee ranges from 50 to 100 basis points (annualized) for covered debt outstanding until the earlier of maturity or June 30, 2012.

The TAGP and DGP are in effect for all eligible entities, unless the entity opted out on or before December 5, 2008. COBNA and CONA are participating in the TAGP. The Corporation, COBNA and CONA remain eligible to participate although the Company has not chosen to issue any debt under the program in the DGP.

Liability for Commonly-Controlled Institutions

Under the cross-guarantee provision of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), insured depository institutions such as the Banks may be liable to the FDIC with respect to any loss incurred or reasonably anticipated to be incurred, by the FDIC in connection with the default of, or FDIC assistance to, any commonly controlled insured depository institution. The Banks are commonly controlled within the meaning of the FIRREA cross-guarantee provision.

Subprime Lending Guidelines

On January 31, 2001, the federal banking agencies issued Expanded Guidance for Subprime Lending Programs (the Guidelines). The Guidelines, while not constituting a formal regulation, provide guidance to the federal bank examiners regarding the adequacy of capital and loan loss reserves held by insured depository institutions engaged in subprime lending. The Guidelines adopted a broad definition of subprime loans which likely covers more than one-third of all consumers in the United States. Because our business strategy is to provide credit card products and other consumer loans to a wide range of consumers, we believe that a portion of our loan assets are viewed by the examiners as subprime. Thus, under the Guidelines, bank examiners could require COBNA to hold additional capital (from one and one-half to three times the minimally required level of capital, as set forth in the Guidelines), or additional loan loss reserves, against such assets. As described above, as of December 31, 2008 COBNA met the requirements for a well-capitalized institution. Federal examiners, however, have wide discretion as to how to apply the Guidelines and there can be no assurances that COBNA or CONA may not be required to hold additional regulatory capital against such assets.

For purposes of the Guidelines, we treat as subprime all loans in COBNA s programs that are targeted at customers either with a Fair, Isaac and Company (FICO) score of 660 or below or with no FICO score. COBNA holds on average 200% of the total risk-based capital requirement that would otherwise apply to such assets.

FFIEC Account Management Guidance

On January 8, 2003, the Federal Financial Institutions Examination Council (FFIEC) released Account Management and Loss Allowance Guidance (the Guidance). The Guidance applies to all credit lending of regulated financial institutions and generally requires that banks properly manage several elements of their lending programs, including line assignments, over-limit practices, minimum payment and negative amortization, workout and settlement programs, and the accounting methodology used for various assets and income items related to loans.

We believe that our account management and loss allowance practices are prudent and appropriate and, therefore, consistent with the Guidance. We caution, however, that similar to the subprime Guidelines, the Guidance provides wide discretion to bank regulatory agencies in the application of the Guidance to any particular institution and its account management and loss allowance practices. Accordingly, under the Guidance, bank examiners could require changes in our account management or loss allowance practices in the future, and such changes could have an adverse impact on our financial condition or results of operation.

OCC Minimum Payment Rules

Shortly after conversion of COBNA to a national association, COBNA implemented minimum payment requirements established by the OCC for the credit card industry. The OCC s minimum payment policies are designed to force modest positive amortization for all card accounts. Under the new policy, the monthly minimum payment is set at 1% of principal balance, plus all interest assessed in the prior cycle, plus any past due fees and certain other fees assessed in the prior cycle. This compares to the Company s previous policy, which for most accounts is a flat 3% of principal balance. This has had the effect of increasing the minimum payment for delinquent customers, while lowering it for many customers who are current. Please refer to Section V, Management Summary and Business Outlook, for a discussion of the impact on the Company of compliance with this policy.

Table of Contents

Privacy and Fair Credit Reporting

The Gramm-Leach-Bliley Act (GLBA) requires a financial institution to describe in a privacy notice certain of its privacy and data collection practices and requires that customers or consumers, before their nonpublic personal information is shared with nonaffiliated third parties, be given a choice (through an opt-out notice) to limit the sharing of such information about them with nonaffiliated third persons unless the sharing is required or permitted under the GLBA as implemented. The Company and the Banks have written privacy notices that are available through the web site of the Company, the relevant legal entity, or both, and are delivered to consumers and customers when required under the GLBA. In accordance with the privacy notices noted above, the Company and the Banks protect the security of information about their customers, educate their employees about the importance of protecting customer privacy, and allow their customers to remove their names from the solicitation lists they use and share with others to the extent they use or share such lists. The Company and the Banks require business partners with whom they share such information to have adequate security safeguards and to abide by the redisclosure and reuse provisions of the GLBA. To the extent that the GLBA and the FCRA require the Company or one or more of the Banks to provide customers and consumers the opportunity to opt out of sharing information, then the relevant entity or entities provide such options in the privacy notice. In addition to adopting federal requirements regarding privacy, the GLBA also permits individual states to enact stricter laws relating to the use of customer information. To date, at least California, Vermont and North Dakota have done so by statute, regulation or referendum, and other states may consider proposals which impose additional requirements or restrictions on the Company and/or the Banks. If the federal or state regulators of the financial subsidiaries establish further guidelines for addressing customer privacy issues, the Company and/or one or more of the Banks may need to amend their privacy policies and adapt their internal procedures.

Like other lending institutions, the Banks utilize credit bureau data in their underwriting activities. Use of such data is regulated under the FCRA on a uniform, nationwide basis, including credit reporting, prescreening, sharing of information between affiliates, and the use of credit data. The Fair and Accurate Credit Transactions Act of 2003 (the FACT Act), which was enacted by Congress and signed into law in December 2003, extends the federal preemption of the FCRA permanently, although the law authorizes states to enact identity theft laws that are not inconsistent with the conduct required by the provisions of the FACT Act. If financial institutions and credit bureaus fail to alleviate the costs and consumer frustration associated with the growing crime of identity theft, financial institutions could face increased legislative/regulatory and litigation risks. In addition, federal regulators are still in the process of promulgating regulations under the FACT Act; there can be no assurance that such regulations, when enacted, will not have an adverse impact on us.

Investment in the Company and the Banks

Certain acquisitions of capital stock may be subject to regulatory approval or notice under federal or state law. Investors are responsible for ensuring that they do not, directly or indirectly, acquire shares of capital stock of the Company in excess of the amount which can be acquired without regulatory approval. Each of the Banks is an insured depository institution within the meaning of the Change in Bank Control Act. Consequently, federal law and regulations prohibit any person or company from acquiring control of the Corporation without, in most cases, prior written approval of the Federal Reserve or the OCC, as applicable. Control is conclusively presumed if, among other things, a person or company acquires more than 25% of any class of voting stock of the Company. A rebuttable presumption of control arises if a person or company acquires more than 10% of any class of voting stock and is subject to any of a number of specified control factors as set forth in the applicable regulations. Additionally, COBNA and CONA are bank within the meaning of Chapter 13 of Title 6.1 of the Code of Virginia governing the acquisition of interests in Virginia financial institutions (the Financial Institution Holding Company Act). The Financial Institution Holding Company Act prohibits any person or entity from acquiring, or making any public offer to acquire, control of a Virginia financial institution or its holding company without making application to, and receiving prior approval from, the Bureau of Financial Institutions.

Non-Bank Activities

The Company s non-bank subsidiaries are subject to supervision and regulation by various other federal and state authorities. Insurance agency subsidiaries are regulated by state insurance regulatory agencies in the states in which they operate. Capital One Agency LLC is a licensed insurance agency that is regulated by the New York State Insurance Department in its home state and by the state insurance regulatory agencies in the states in which it operates. Capital One Agency LLC provides both personal and business insurance services to retail and commercial clients.

Capital One Asset Management, LLC and Capital One Financial Advisors, LLC are registered investment advisers regulated under the Investment Advisers Act of 1940. Capital One Asset Management provides investment advice to institutions, foundations and endowments, and high net worth individuals.

Table of Contents

Capital One Investment Services, LLC and Capital One Southcoast Capital, Inc. are registered broker-dealers regulated by the Securities and Exchange Commission and the Financial Industry Regulatory Authority. The Company s broker-dealer subsidiaries are subject to, among other things, net capital rules designed to measure the general financial condition and liquidity of a broker-dealer. Under these rules, broker-dealers are required to maintain the minimum net capital deemed necessary to meet their continuing commitments to customers and others, and are required to keep a substantial portion of their assets in relatively liquid form. These rules also limit the ability of broker-dealers to transfer large amounts of capital to parent companies and other affiliates. Broker-dealers are also subject to other regulations covering their business operations, including sales and trading practices, public offerings, publication of research reports, use and safekeeping of client funds and securities, capital structure, record-keeping and the conduct of directors, officers and employees.

USA PATRIOT Act of 2001

The USA PATRIOT Act of 2001 (the Patriot Act) contains sweeping anti-money laundering and financial transparency laws as well as enhanced information collection tools and enforcement mechanisms for the U.S. government, including due diligence requirements for private banking and correspondent accounts; standards for verifying customer identification at account opening; rules to promote cooperation among financial institutions, regulators, and law enforcement in identifying parties that may be involved in terrorism or money laundering; reporting requirements applicable to the receipt of coins and currency of more than $10,000 in nonfinancial trades or businesses; and more broadly applicable suspicious activity reporting requirements.

The Department of Treasury in consultation with the Federal Reserve and other federal financial institution regulators has promulgated rules and regulations implementing the Patriot Act that prohibit correspondent accounts for foreign shell banks at U.S. financial institutions; require financial institutions to maintain certain records relating to correspondent accounts for foreign banks; require financial institutions to produce certain records upon request of the appropriate federal banking agency; require due diligence with respect to private banking and correspondent banking accounts; facilitate information sharing between government and financial institutions; require verification of customer identification; and require financial institutions to have an anti-money laundering program in place.

Interstate Taxation

Several states have passed legislation which attempts to tax the income from interstate financial activities, including credit cards, derived from accounts held by local state residents. The Company has accounted for this matter applying the recognition and measurement criteria of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109,* (FIN 48).

Legislation

Throughout 2007 and 2008, Congress introduced legislation focused on a number of areas related to Capital One s businesses. During the same period, eleven Congressional hearings were held and numerous legislative proposals introduced on credit card practices. Legislation restricting credit card terms passed the U.S. House of Representatives in September 2008, but did not pass the U.S. Senate. Concurrently, the Federal Reserve Board issued final rules in December 2008 that address many of the same issues raised by legislators. See Regulation of Lending Activities in Item 1. Supervision and Regulation. The effective date of the regulations is July 1, 2010. Legislation has been introduced in Congress and may potentially be considered in both the U.S. House and the U.S. Senate in 2009 that would impact the implementation period of the Federal Reserve rules or extend limitations to additional practices.

In 2008, legislation was also introduced to regulate interchange fees. Several hearings were held, but the legislation was not considered by the full House or by the U.S. Senate. This issue is expected to continue to be debated in Congress in 2009 and also at the state level.

In 2008, Congress also focused on the housing market, looking at both retrospective and prospective solutions. In July 2008, legislation was enacted to create additional federal backstops and strengthen regulation of the Government Sponsored Enterprises (GSEs), including an overhaul of Federal Housing Administration (FHA) programs. In October 2008, the Emergency Economic Stabilization Act (EESA) was enacted, which, among other things, authorized the U. S. Treasury Department to create a $700 billion Troubled Assets Relief Program (TARP) originally created to address troubled mortgage assets. In November 2008, the Treasury approved the Company s participation in one of the programs implemented under the EESA, the TARP Capital Purchase Program (the CPP). Treasury continues to refine the regulations implementing the CPP, and it is unclear at this time what its final form will be. Additional programs are also being created that utilize TARP monies such as the Federal Reserve s Term Asset Loan Facility (TALF).

Under the EESA the Company is subject to increased Congressional scrutiny, including participating in Congressional hearings and investigations and providing reports to the Treasury Department and the Government Accountability Office (GAO) as well as other entities created under the EESA to provide additional oversight. Congress has shown a strong interest in directing how the monies and programs under the EESA are managed. To this end, the U.S. House of Representatives has passed legislation addressing a number of terms of the EESA and a number of hearings have been scheduled. Recently Congress passed, and the President signed into law, the American Recovery and Reinvestment Act (ARRA), which, among other things, includes additional restrictions for participants in programs under the EESA. Such restrictions include limitations on hiring workers under the H1-B visa program and compliance with new standards to be adopted by the U.S. Treasury relating to the executive compensation practices of participants in programs under the TARP. The ARRA also includes provisions that would allow the Company to redeem the Series A Preferred Stock that it issued to the U.S. Treasury under the CPP using proceeds other than those received from a qualified equity offering under certain circumstances and with regulator approval. In addition, it is expected that provisions related to mortgage loans and modifications are likely to be forthcoming. For additional information regarding the Company s participation in the CPP please see Section V, Management Summary and Business Outlook, and Item 8, Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 10.

Finally, there have been several proposals in Congress to modify the bankruptcy laws to permit homeowners at risk of foreclosure to modify their primary mortgages. On October 20, 2008, the President signed the National Guard and Reservists Debt Relief Act of 2008, making bankruptcy filings easier for national guardsmen and reservists. Broad bankruptcy legislation also has been introduced in 2009 that could be seen as creating incentives for consumers to choose Chapter 13 bankruptcy as a primary remedy for mortgage related problems, which could lead to an increase in bankruptcy filings. This legislation passed the U.S. House in February and now heads to the U.S. Senate for possible consideration.

Please see Compliance With New and Existing Laws and Regulations May Increase Our Costs, Limit Our Ability To Pursue Business Opportunities, And Increase Compliance Challenges under Item 1A. Risk Factors for a discussion of the risks posed to the Company as a result of the current legislative environment.

Sarbanes-Oxley Act Compliance

On July 30, 2002, the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act) was passed into law. The Sarbanes-Oxley Act applies to all companies that are required to file periodic reports with the Securities and Exchange Commission (SEC) and contains a number of significant changes relating to the responsibilities of directors and officers and reporting and governance obligations of SEC reporting companies. In addition, the Sarbanes-Oxley Act also created the Public Company Accounting Oversight Board (the PCAOB), a private sector, non-profit corporation whose mission is to oversee the auditors of public companies. The PCAOB recommends rulemaking to the SEC and sets certain standards for the auditors which it oversees. Since the passage of the Sarbanes-Oxley Act, we have taken a variety of steps that we believe place us in substantial compliance with the effective provisions of the Sarbanes-Oxley Act. We continue to monitor SEC rulemaking and PCAOB activities to determine if additional changes are needed to comply with provisions that may become effective in the future. Furthermore, our management has supervised the design of, or has designed, internal controls and procedures to provide reasonable assurances regarding the reliability of its financial reporting and disclosure controls and procedures to ensure that material information regarding the Company is made known to them, particularly during the period in which this Annual Report on Form 10-K is being prepared and has evaluated the effectiveness of those controls as more fully set forth in Controls and Procedures below. We have, in compliance with Section 404 of the Sarbanes-Oxley Act, certified, in connection with this Annual Report on Form 10-K, that we did not discover, during the execution of our internal control processes, any material weaknesses. In addition, our management policy is to disclose to our auditors and the Audit and Risk Committee of the Board of Directors significant deficiencies, if any, in the design or operation of our internal control over financial reporting that are reasonably likely to adversely affect our ability to record, process, summarize and report financial information, as well as any fraud, whether or not material, by those that have a significant role in these processes.

Regulation of International Business by Non - U.S. Authorities

COBNA faces regulation in foreign jurisdictions where it currently operates. In the United Kingdom, COBNA operates through the U.K. Bank, which was established in 2000. The U.K. Bank is regulated by the Financial Services Authority (FSA) and licensed by the Office of Fair Trading (OFT). The U.K. Bank is an authorized deposit taker and thus is able to take consumer deposits in the U.K. The U.K. Bank also has been granted a full license by the OFT to issue consumer credit under the U.K. s Consumer Credit Act. The FSA requires the U.K. Bank to maintain certain regulatory capital ratios at all times, and it may modify those requirements at any time. Effective January 1, 2008, the U.K. Bank has become subject to new capital adequacy requirements implemented by the FSA as a result of the U.K. s adoption of the European Capital Requirements Directive, itself an implementation of the Basel II Accord. The U.K. Bank obtains capital through earnings or through additional capital infusion from COBNA, subject to approval under Regulation K of the rules administered by the Federal Reserve. If the U.K. Bank is unable to generate or maintain sufficient capital on favorable terms, it may choose to restrict its growth to reduce the regulatory capital required. Following the introduction of the Capital Requirements Directive, the U.K. Bank continues to have a capital surplus and the impact of the new capital regime has been fully factored into the U.K. Bank s financial and capital planning. In addition, the U.K. Bank is limited by the U.K. Companies Act in its distribution of dividends to COBNA in that dividends may only be paid out of the U.K. Bank s distributable profits.

As in the U.S., in non-U.S. jurisdictions where we operate, we face a risk that the laws and regulations that are applicable to us (or the interpretations of existing laws by relevant regulators) may change in ways that adversely impact our business.

The OFT is investigating Visa s and MasterCard s current methods of setting interchange fees applicable to U.K. domestic transactions. Cross-border interchange fees are also coming under scrutiny from the European Commission (EC), which in December 2007 issued a decision notice stating that MasterCard s interchange fees applicable to cross border transactions are in breach of European Competition Law. MasterCard has appealed this decision. A similar decision is expected in relation to Visa s cross border interchange fees. The timing of any final resolution of the matter by EC or OFT is uncertain and it is most unlikely that there will be any determination before the end of 2009. However, it is likely that interchange fees will be reduced, which could adversely affect the yield on U.K. credit card portfolios.

Table of Contents

Following a referral by the OFT, the Competition Commission (CC) launched a market investigation into the supply of Payment Protection Insurance (PPI) in the U.K. PPI on mortgages, credit cards, unsecured loans (personal loans, motor loans and hire purchase) and secured loans are included. The CC published its final report on remedies on January 29, 2009, which included point of sale changes and the introduction of an annual PPI statement to customers. All changes will take effect in 2010. The U.K. Bank will likely see an increase in customer cancellations and complaints beginning in 2009, and will stop selling PPI to new customers in 2010. The U.K. Bank continues to consider alternative products to help mitigate these impacts.

Following the change in the U.S. regulator of COBNA in 2008 to the OCC, U.K. Bank has been included in various discovery examinations by the OCC. Following their visit to the U.K. Bank in November 2008, the OCC has requested that all U.K. lenders which have a U.S. parent company amend the way in which they calculate the minimum monthly payment requested from customers. The new calculation goes beyond what is currently required of UK lenders under the Banking Code and other U.K. legislation, and therefore means that the U.K. Bank will be subject to additional regulation over and above its U.K. competitors who are not U.S. owned. The potential exists for further U.S. legislation to be selectively applied by the OCC to U.K. banks with U.S. parents.

The European Payment Services Directive (PSD) aims to harmonize the regulatory regime for payment services across the European Union (E.U.). The PSD, which is due to be implemented on November 1, 2009, sets minimum standards for payment services, including new information which must be provided to consumers and the introduction of new faster execution times for payment transactions. The PSD is intended to allow U.K. payment institutions to significantly expand their markets by offering their services across the E.U. It may encourage new entrants to the payment arena, in particular for mobile phone technology to be used to enable payments. The changes may also offer benefits to consumers by increasing competition in the market leading to lower prices and a wider choice of services. The final payment services regulations have not been issued, but the U.K. Bank is exploring its impact given the short time frame for implementation.

Statistical Information

The statistical information required by Item 1 can be found in Item 6 Selected Financial Data , Item 7 Management Discussion and Analysis of Financial Condition and Results of Operations and in Item 8, Financial Statements and Supplementary Data .

Item 1A. *Risk Factors*

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We also may make written or oral forward-looking statements in our periodic reports to the Securities and Exchange Commission on Forms 10-Q and 8-K, in our annual report to shareholders, in our proxy statements, in our offering circulars and prospectuses, in press releases and other written materials and in statements made by our officers, directors or employees to third parties. Statements that are not about historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements include, but are not limited to, information relating to our future earnings per share, growth in managed loans outstanding, product mix, segment growth, tangible common equity, managed revenue margin, funding costs, operations costs, employment growth, marketing expense, delinquencies and charge-offs. Forward looking statements also include statements using words such as expect, anticipate, hope, intend, plan, believe, esti similar expressions.

Forward-looking statements are not guarantees of future performance. They involve risks, uncertainties and assumptions, including the risks discussed below. Our future performance and actual results may differ materially from those expressed in forward-looking statements. Many of the factors that will determine these results and values are beyond our ability to control or predict. Forward-looking statements speak only as of the date that they are made, and we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

This section highlights specific risks that could affect our business. Although we have tried to discuss all material risks, please be aware that other risks may prove to be important in the future. In addition to the factors discussed elsewhere in this report, among the other factors that could cause actual results to differ materially from our forward looking statements are the following:

The Current Business Environment, Including the Current Economic Downturn, May Adversely Affect Our Industry, Business, Results Of Operations And Capital Levels

The current global recession has resulted in a general tightening in the credit markets, lower levels of liquidity, reduced asset values (including residential and commercial properties), reduced business profits, increased rates of business and consumer delinquency, and increased rates of consumer bankruptcy, some of which have had a negative impact on our results of operation. Continued economic weakness may hurt our financial performance as customers default on their loans or maintain lower deposit levels, or in the case of credit card accounts, carry lower balances and reduce credit card purchase activity. A prolonged global recession could have a material adverse effect on our financial condition and results of operations.

Table of Contents

Furthermore, dramatic declines in the housing market over the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities as well as major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities, in turn, have caused many financial institutions to turn to the government for extraordinary financial assistance, to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally and the strength of credit counterparties, many lenders and institutional investors have reduced or eliminated their funding to even the most credit-worthy borrowers or to other financial institutions. The resulting lack of available credit and lack of confidence in the financial markets could materially and adversely affect our access to capital and financial condition.

In particular, we may face the following risks in connection with these events:

Market developments may affect consumer confidence levels and may cause declines in credit card usage and adverse changes in payment patterns, causing increases in delinquencies and default rates, which could have a negative impact on our results of operations.

The processes we use to estimate inherent losses may no longer be reliable because they rely on complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation, which could have a negative impact on our business.

Our ability to assess the creditworthiness of our customers may be impaired if the criteria and/or models we use to underwrite and manage our customers become less predictive of future losses, which could cause our losses to rise and have a negative impact on our results of operations.

Our ability to borrow from other financial institutions or to engage in securitization or unsecured funding transactions on favorable terms or at all could be adversely affected by further disruptions in the capital markets or other events, including actions by rating agencies and deteriorating investor expectations, which could limit our access to funding. As a result of these current market conditions, we have increased our reliance on deposit funding. This shift results in higher levels of owned loan receivables and related increases in our allowance for loan and lease losses.

Increased charge-offs, rising LIBOR and other events may cause our securitization transactions to amortize earlier than scheduled or increase certain capital requirements, which could accelerate our need for additional funding or have a significant effect on the ability of certain of our business entities to meet capital adequacy requirements.

An inability to accept or maintain deposits or to obtain other sources of funding could materially effect our liquidity position and our ability to fund our business. Many other financial institutions are increasing their reliance on deposit funding, including newly formed bank holding companies and, as such, we expect increased competition in the deposit markets. We cannot predict how this increased competition will affect our costs. If we are required to offer higher interest rates to attract or maintain deposits, our funding costs will be adversely impacted. In addition, our ability to maintain existing or obtain additional deposits may be impacted by factors beyond our control, including perceptions about our financial strength, which could lead to consumers choosing not to make deposits with us.

Regulators, rating agencies or investors could change their standards regarding appropriate capital levels for banks in general or our company in particular. If we are unable to meet any such new standards, it could have negative impacts on our ability to lend, to grow deposits, and on our business results.

Increased prepayments, refinancings or other factors could lead to a reduction in the value of our mortgage servicing rights, which could have a negative impact on our financial results.

Compliance With New And Existing Laws And Regulations May Increase Our Costs, Limit Our Ability To Pursue Business Opportunities, And Increase Compliance Challenges

There has been increased legislation and regulation with respect to the financial services industry in recent months, and we expect that oversight of our business will continue to expand in scope and complexity. A wide array of banking, consumer lending, and deposit laws apply to almost every aspect of our business. Failure to comply with these laws and regulations could result in financial, structural and operational penalties, including receivership. In addition, establishing systems and processes to achieve compliance with these laws and regulations may increase our costs and/or limit our ability to pursue certain business opportunities.

Our participation in the TARP Capital Purchase Program (the CPP) subjects us to increased oversight by the Treasury Department, regulators and Congress under the Emergency Economic Stabilization Act of 2008 (EESA). Congress may adopt further legislation to refine EESA in addition to other efforts to change lending practices that legislators believe led to the current economic situation. Such legislation could increase governmental oversight of the Company, restrict the Company s lending or governance practices, or both, all of which could negatively impact our business and revenues.

Table of Contents

In addition, the Federal Reserve Board recently passed amendments to Regulation AA (Unfair or Deceptive Acts or Practices) and Regulation Z (Truth in Lending), effective July 1, 2010, which limit or prohibit certain credit card practices and require increased disclosures for consumers. Although the Company has not engaged in many of the practices prohibited by the amendments, the rules could have a material adverse effect on future revenues in our U.S. credit card business and could make the card business generally less resilient in future economic downturns. In particular, the rules will prohibit an increase in the interest rates applied to existing credit card balances except in limited circumstances. Likewise, several bills pending before Congress could impact credit card pricing and other terms.

In addition, legislation has been introduced that could enable merchants to negotiate interchange fees, which is the discount on the payment due from the card-issuing bank to the merchant bank through the interchange network. The future of these bills is uncertain, but each, or additional legislation, could be introduced or reintroduced in 2009. We face similar risks with respect to our international businesses, where changing laws and regulations may have an adverse impact on our results.

In April 2008, the Financial Accounting Standards Board (FASB) voted to eliminate Qualifying Special Purpose Entities (QSPEs) from the guidance in SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities. This change could have a significant impact on the Company s consolidated financial statements because the Company could lose sales treatment for assets previously sold to a QSPE, as well as for future sales. As of December 31, 2008, the Company had approximately $45.9 billion of credit card receivables held by QSPEs. If the Company is required to hold more of these assets on its balance sheet, the Company could be required to comply with increased regulatory capital requirements and such capital may not be available on terms favorable to the Company, if at all. If the Company were to fail to comply with any additional capital requirements, it could have a negative impact on our business. Likewise, if the Company is required to hold additional assets on its balance sheet, the Company may also have to increase its allowance for loan and lease losses to account for potential losses with respect to such assets. If the Company were to increase its allowance for loan and lease losses, it could have a negative impact on the Company s financial results.

Finally, in January 2009, broad bankruptcy legislation was introduced in Congress that could be seen as creating incentives for consumers to choose Chapter 13 bankruptcy as a primary remedy for mortgage related problems. Such legislation, if enacted, could result in an increase in bankruptcy filings, which could lead to increased credit losses in certain of our other lending businesses, such as credit cards and auto finance, and could have an overall negative impact on our results of operation.

Laws and regulations, and any interpretations and applications with respect thereto, generally are intended to benefit consumers, borrowers and depositors, not shareholders. The legislative and regulatory environment is beyond our control, may change rapidly and unpredictably and may negatively influence our earnings and growth. In addition, some of these new laws and regulations may increase our costs. Our success depends on our ability to maintain compliance with both existing and new laws and regulations. For a description of the laws and regulations to which we are subject, please refer to Supervision and Regulation in Item 1.

The Capital Markets And Credit Environment Have Experienced Unprecedented Levels Of Volatility, Which Could Have A Negative Impact On Our Business

The capital markets have experienced and are continuing to experience extended volatility and disruption, which has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock price and credit capacity for issuers without regard to those issuers underlying financial strength. Such market conditions may limit the Company s ability to replace, in a timely manner, maturing liabilities, satisfy regulatory capital requirements and access the capital necessary to maintain and grow our business. As such, the Company may be forced to delay raising capital or bear an unattractive cost of capital, which could limit financial flexibility and ultimately jeopardize its overall liquidity and capital position. In the event the Company needs to preserve its capital levels or raise additional capital, the current level of dividends paid to shareholders may decrease and the price at which additional capital may be raised could be dilutive to existing shareholders.

Similarly, as a result of the extreme dislocation in the marketplace, the market value of assets in the Company s investment portfolio has declined, and such decline may be lasting or could become even more severe. Such decline has increased and could continue to increase the Company s unrealized losses, which could have a negative impact on the Company s capital position.

In response to this market dislocation, the federal government has taken unprecedented government action, including the various programs implemented by the U.S. Treasury to inject capital into the financial system. However, there is no guarantee that the Treasury s programs will necessarily benefit the financial markets in general or the Company in particular. In addition, the Company could also be adversely impacted if certain of its competitors are beneficiaries of certain of the government s programs and the Company does not receive comparable assistance. The government may not continue to intervene in the financial markets, and any governmental intervention may not have a positive impact on the Company s business, financial condition or results of operations.

Table of Contents

We May Experience Increased Delinquencies And Credit Losses

Like other lenders, we face the risk that our customers will not repay their loans. Rising losses or leading indicators of rising losses (such as higher delinquencies, non-performing loans, or bankruptcy rates; lower collateral values; rising unemployment rates) may require us to increase our allowance for loan and lease losses, which may degrade our profitability if we are unable to raise revenue or reduce costs to compensate for higher losses. In particular, we face the following risks in this area:

Missed Payments. Our customers may miss payments. Loan charge-offs (including from bankruptcies) are generally preceded by missed payments or other indications of worsening financial condition. Our reported delinquency levels measure these trends. Customers are more likely to miss payments during an economic downturn. In addition, we face the risk that consumer and commercial customer behavior may change (i.e. an increased unwillingness or inability to repay debt), causing a long-term rise in delinquencies and charge-offs.

Estimates of inherent losses. The credit quality of our portfolio can have a significant impact on our earnings. We allow for and reserve against credit risks based on our assessment of credit losses inherent in our loan portfolios. This process, which is critical to our financial results and condition, requires complex judgments, including forecasts of economic conditions, which may no longer be capable of accurate estimation. We may underestimate our inherent losses and fail to hold a loan loss allowance sufficient to account for these losses. Incorrect assumptions could lead to material underestimates of inherent losses and inadequate allowance for loan and lease losses. In addition, our estimate of inherent losses impacts the amount of allowances we build to account for those losses. The increase or release of allowances impacts our current financial results.

Underwriting. Our ability to assess the credit worthiness of our customers may diminish. If the models and approaches we use to select, manage, and underwrite our consumer and commercial customers become less predictive of future charge-offs (due, for example, to rapid changes in the economy, including the unemployment rate), our credit losses and returns may deteriorate.

Business mix. Our business mix could change in ways that could adversely affect credit losses. We participate in a mix of businesses with a broad range of credit loss characteristics. Consequently, changes in our business mix may change our charge-off rate.

Charge-off recognition. The rules governing charge-off recognition could change. We record charge-offs according to accounting and regulatory guidelines and rules. These guidelines and rules, including the FFIEC Account Management Guidance, could require changes in our account management or loss allowance practices and cause our charge-offs to increase for reasons unrelated to the underlying performance of our portfolio. Such changes could have an adverse impact on our financial condition or results of operation.

Mortgage repurchases. We may be required to repurchase mortgage loans that we sell to investors in the event that there was improper underwriting or fraud, or in the event that the loans become delinquent shortly after they are originated. Typically, loans are put back to originators if they experience delinquencies. Consequently, we may be exposed to credit risk associated with sold loans. We hold a reserve against this risk, but the reserve may not be adequate.

Industry practices. Our charge-off and delinquency rates may be negatively impacted by industry developments, including new regulations applicable to our industry.

Collateral. Collateral, when we have it, could be insufficient to compensate us for loan losses. When customers default on their loans and we have collateral, we attempt to seize it. However, the value of the collateral may not be sufficient to compensate us for the amount of the unpaid loan and we may be unsuccessful in recovering the remaining balance from our customers. Particularly with respect to our commercial lending and mortgage activities, decreases in real estate values could adversely affect the value of property used as collateral for our loans and investments. Thus, the recovery of such property could be insufficient to compensate us for the value of these loans.

New York Concentration. Although our lending is geographically diversified, in general, our commercial loan portfolio is concentrated in the New York metropolitan area. The regional economic conditions in the New York area affect the demand for our commercial products and services as well as the ability of our customers to repay their commercial loans and the value of the collateral securing these loans. A prolonged decline in the general economic conditions in the New York region could have a material adverse effect on the performance of our commercial loan portfolio and our results of operations.

The Soundness of Other Financial Institutions Could Adversely Affect Us

Our ability to engage in routine funding transactions could be adversely affected by the stability and actions of other financial services institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients, resulting in a significant credit concentration with respect to the financial services industry overall. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions.

Likewise, adverse developments affecting the overall strength and soundness of our competitors or the financial services industry as a whole could have a negative impact on perceptions about the strength and soundness of our business even if we are not subject to the same adverse developments. In addition, adverse developments with respect to third parties with whom we have important relationships also could negatively impact perceptions about us. These negative perceptions about us could cause our business to suffer and exacerbate the other risks that we face.

Reputational Risk And Social Factors May Impact Our Results

Our ability to originate and maintain accounts is highly dependent upon the perceptions of consumer and commercial borrowers and deposit holders and other external perceptions of our business practices and/or our financial health. Adverse perceptions regarding our reputation in the consumer, commercial and funding markets could lead to difficulties in generating and maintaining accounts as well as in financing them. Particularly, negative perceptions regarding our reputation could lead to decreases in the levels of deposits that consumer and commercial customers and potential customers choose to maintain with us.

In addition, a variety of social factors may cause changes in borrowing activity, including credit card use, payment patterns and the rate of defaults by accountholders and borrowers domestically and internationally. These social factors include changes in consumer confidence levels, the public s perception regarding consumer debt, including credit card use, and changing attitudes about the stigma of personal bankruptcy. If consumers develop negative attitudes about incurring debt or if consumption trends continue to decline, our business and financial results will suffer.

Goodwill Impairment Could Negatively Impact Our Net Income And Stockholders Equity

Goodwill is not amortized, but is tested for impairment at the reporting unit level, which is an operating segment or one level below an operating segment. Goodwill is required to be tested for impairment annually and between annual tests if events or circumstances indicate that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. There are numerous risks that may cause the fair value of a reporting unit to fall below its carrying amount, which could lead to the measurement and recognition of goodwill impairment. These risks include, but are not limited to, adverse changes in legal factors or the business climate, an adverse action or assessment by a regulator, the loss of key personnel, a more-likely-than-not expectation that all or a significant portion of a reporting unit may be disposed of, failure to realize anticipated synergies from acquisitions, a sustained decline in the Company s market capitalization, significant negative variances between actual and expected financial results, and lowered expectations of future financial results. The Company recorded $810.9 million of goodwill impairment in 2008, and as of December 31, 2008, had approximately $12.0 billion of goodwill remaining on its balance sheet. Declines in the Company s market capitalization increase the risk of further goodwill impairment in 2009.

We Face Intense Competition in All of Our Markets

We operate in a highly competitive environment, and we expect competitive conditions to continue to intensify. In such a competitive environment, we may lose entire accounts, or may lose account balances, to competing financial institutions, or find it more costly to maintain our existing customer base. Customer attrition from any or all of our lending products, together with any lowering of interest rates or fees that we might implement to retain customers, could reduce our revenues and therefore our earnings. Similarly, customer attrition from our deposit products, in addition to an increase in rates and/or services that we may offer to retain those deposits, may increase our expenses and therefore reduce our earnings. We expect that competition will continue to grow more intensely with respect to most of our products. Some of our competitors may be substantially larger than we are, which may give those competitors advantages, including a more diversified product and customer base, the ability to reach out to more customers and potential customers, operational efficiencies, more versatile technology platforms, broad-based local distribution capabilities, lower-cost funding, and larger existing branch networks. In addition, some of our competitors may not be subject to the same regulatory requirements or legislative scrutiny to which we are subject, which also could place us at a competitive disadvantage.

Fluctuations In Market Interest Rates Or The Capital Markets Could Adversely Affect Our Revenue And Expense, The Value Of Assets And Obligations, Our Cost Of Capital Or Our Liquidity

Like other financial institutions, our business may be sensitive to market interest rate movement and the performance of the financial markets. Changes in interest rates or in valuations in the debt or equity markets could directly impact us. First, we borrow money from other institutions and depositors, which we use to make loans to customers and invest in debt securities and other earning assets.

Table of Contents

We earn interest on these loans and assets and pay interest on the money we borrow from institutions and depositors. Fluctuations in interest rates, including changes in the relationship between short term rates and long term rates and in the relationship between our funding basis rate and our lending basis rate, may have negative impacts on our net interest income and therefore our earnings. In addition, interest rate fluctuations and competitor responses to those changes may affect the rate of customer pre-payments for auto and other term loans and may affect the balances customers carry on their credit cards. These changes can reduce the overall yield on our earning asset portfolio. Changes in interest rates and competitor responses to these changes may also impact customer decisions to maintain balances in the deposit accounts they have with us. These changes may require us to replace withdrawn balances with higher cost alternative sources of funding. In addition, changes in valuations in the debt and equity markets could have a negative impact on the assets we hold in our investment portfolio. Finally, such market changes could also have a negative impact on the valuation of assets for which we provide servicing.

We assess our interest rate risk by estimating the effect on our earnings under various scenarios that differ based on assumptions about the direction and the magnitude of interest rate changes. We take risk mitigation actions based on those assessments. We face the risk that changes in interest rates could reduce our net interest income and our earnings in material amounts, especially if actual conditions turn out to be materially different than those we assumed.

See Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations Interest Rate Risk Management for additional information.

We May Fail To Realize All Of The Anticipated Benefits Of Our Mergers And Acquisitions

Capital One has engaged in merger and acquisition activity over the past several years. If we are not able to achieve the anticipated benefits of such mergers and acquisitions, including cost savings and other synergies, our business could suffer. In addition, it is possible that the ongoing integration processes could result in the loss of key employees, the disruption of each company s ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with clients, customers, depositors and employees or to achieve the anticipated benefits of the merger or acquisition. Integration efforts also may divert management attention and resources. These integration matters may have an adverse effect on the Company during any transition period.

Our recent acquisitions also involve our entry into new businesses and new geographic or other markets which present risks resulting from our relative inexperience in these new areas and/or these new businesses. These new businesses change the overall character of our consolidated portfolio of businesses and could react differently to economic and other external factors. We face the risk that we will not be successful in these new businesses and/or in these new markets.

We Face Risk Related To The Strength Of Our Operational, Technological And Organizational Infrastructure

Our ability to grow and compete is dependent on our ability to build or acquire the necessary operational and technological infrastructure and to manage the cost of that infrastructure while we expand and as we integrate acquired businesses. Similar to other large corporations, operational risk can manifest itself in many ways, such as errors related to failed or inadequate processes, faulty or disabled computer systems, fraud by employees or persons outside of the Company and exposure to external events. We are dependent on our operational infrastructure to help manage these risks. From time to time, we may need to change or upgrade our technology infrastructure. We may experience disruption, and we may face additional exposure to these risks during the course of making such changes. In addition, as we acquire other institutions, we face additional challenges when integrating different operational platforms. Such integration efforts may be more disruptive to the business and/or more costly than we anticipate.

In some cases, we outsource the maintenance and development of our operational and technological functionality to third parties. These third parties may experience errors or disruptions that could adversely impact us and over which we may have limited control. Any increase in the amount of our infrastructure that we outsource to third parties may increase our exposure to this risk.

In addition, we are heavily dependent on the strength and capability of our technology systems which we use both to interface with our customers and to manage our internal financial and other systems. Our ability to develop and deliver new products that meet the needs of our existing customers and attract new ones depends on the functionality of our technology systems. Our ability to develop and implement effective marketing campaigns also depends on our technology. Additionally, our ability to run our business in compliance with applicable laws and regulations is dependent on these infrastructures. Any disruptions or failures of our infrastructure or technology systems could cause us to be unable to market, manage and report on our products, services and financial results in a timely and accurate manner.

22

Table of Contents

The Company s Business Could Suffer If It Is Unable To Attract, Retain and Motivate Skilled Senior Leaders

The Company s success depends, in large part, on its ability to retain key senior leaders, and competition for such senior leaders can be intense in most areas of the Company s business. The executive compensation provisions of the EESA, including amendments to such provisions implemented under the American Recovery and Reinvestment Act of 2009, are expected to limit the types of compensation arrangements that the Company may enter into with its most senior leaders upon adoption of implementing standards by the U.S. Treasury These standards, and any further legislation or regulation restricting executive compensation could have a negative impact on the Company s ability to attract, retain and motivate such leaders in support of the Company s long-term strategy. In addition, many of the companies with which the Company competes for senior talent may not be subject to such compensation limitations. If we are unable to retain talented senior leadership, our business could suffer.

Certain Of Our Businesses Are Subject To Increased Litigation Risks

Our credit card business is subject to increased litigation as a result of the structure of the credit card industry, and we face risks from the outcomes of such industry litigation. Substantial legal liability against the Company could have a material adverse financial effect or cause significant reputational harm to us, which could seriously harm our business. For a full description of the litigation risks that we face in connection with the structure of the credit card industry, please refer to Industry Litigation in Item 8 Financial Statements and Supplementary Data Notes to the Financial Statements Note 19.

We Face The Risk Of Fluctuations In Our Expenses And Other Costs That May Hurt Our Financial Results

Our expenses and other costs, such as operating, labor and marketing expenses, directly affect our earnings results. In light of the extremely competitive environment in which we operate, and because the size and scale of many of our competitors provide them with increased operational efficiencies, it is important that we are able to successfully manage our expenses. Many factors can influence the amount of our expenses, as well as how quickly they may increase. Investments in infrastructure, which may be necessary to maintain a competitive business, may increase operational expenses in the short-run. As our business develops, changes or expands, additional expenses can arise from management of outsourced services, asset purchases, structural reorganization, a reevaluation of business strategies and/or expenses to comply with new or changing laws or regulations. Integration of acquired entities may also increase our expenses, and we may be less able to predict the operational expenses of newly acquired businesses. In addition, we face the risk that the benefits of the Company s cost savings initiative may not be fully realized. If we are unable to successfully manage our expenses, our financial results will suffer.

We Face Risks From Unpredictable Catastrophic Events

Natural disasters or other catastrophic events, including terrorist attacks, may have a negative effect on our business and infrastructure, including our information technology systems. Due to our banking locations in Louisiana and Texas, we are exposed to hurricanes and related damage; in New York and New Jersey, severe winter weather could impact our operations. The impact of such events and other catastrophes on the overall economy may also adversely affect our financial condition or results of operations.

We Face Risks From The Use Of Estimates In Our Financial Statements

Pursuant to United States Generally Accepted Accounting Principles (US GAAP), we are required to use certain assumptions and estimates in preparing our financial statements, including in determining the fair value of certain assets and liabilities, among other items. If the assumptions or estimates underlying the Company s financial statements are incorrect, the Company may experience unexpected material losses. For a discussion of how we use estimates in accordance with US GAAP, please refer to Significant Accounting Policies in Item 8 Financial Statements and Supplementary Data Notes to the Financial Statements Note 1.

Item 1B. ***Unresolved Staff Comments.***

Not applicable.

Item 2. ***Properties.***

Our real estate portfolio is used to support all of our business segments. We own the 587,000 square foot headquarters building located at 1680 Capital One Drive in McLean, Virginia. The building houses our executive offices and Northern Virginia staff.

We own approximately 316 acres of land in Goochland County, Virginia which consolidates our Richmond operations and houses various functions (the West Creek Campus). The Company has seven office buildings, a support facility and a training center at the West Creek Campus. Totaling nearly 1.2 million square feet, the West Creek Campus houses multiple business and staff groups. Another 460,000 square feet in office, data and production space is owned in Richmond, Virginia, along with a 344,075 square foot facility in Nottingham, United Kingdom, from which we conduct credit, collections, customer service and other operations.

Our businesses also occupy leased space totaling, in the aggregate, approximately 450,000 square feet in locations across Richmond, Virginia and Toronto, Canada.

Table of Contents

Our Local Banking segment s office and branch operations are conducted primarily utilizing approximately 3.4 million square feet in owned properties and 3.7 million square feet in leased locations across Louisiana, New Jersey, New York and Texas. Portions of the office portfolio are sub-leased where internal demand permits. Additionally, to support our mortgage businesses, we lease facilities totaling approximately 261,000 square feet in California and Kansas. Additionally, our Auto Finance sub-segment leases just under 600,000 square feet of leased office space in various locations including California, Florida, Georgia, Illinois, Louisiana, Michigan and Oklahoma with the majority of such space in Texas. An additional 73,000 square feet of leased space in Boston and Framingham, Massachusetts supports other portions of the National Lending segments.

Item 3. Legal Proceedings.

The information required by Item 3 is included in Item 8, Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 19.

Item 4. Submission of Matters to a Vote of Security Holders.

During the fourth quarter of our fiscal year ending December 31, 2008, no matters were submitted for a vote of our stockholders.

Table of Contents

PART II

Item 5. ***Market for Company s Common Equity and Related Stockholder Matters.***

(Dollars in thousands, except per share information)	Total Number of Shares Purchased(1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans(1)	Maximum Amount That May Yet be Purchased Under the Plan or Program(1)
October 1-31, 2008	3,261	$ 48.78	0	$ 2,000,000
November 1-30, 2008	1,329	31.82	0	$ 2,000,000
December 1-31, 2008	10,738	29.87	0	$ 2,000,000
Total	15,328		0	

(1) Shares purchased represent shares purchased and share swaps made in connection with stock option exercises and the withholding of shares to cover taxes on restricted stock lapses. The stock repurchase program is intended to comply with Rules 10b5-1(c) (1) (i) and 10b-18 of the Securities Exchange Act of 1934, as amended. See note 10 for additional information.

Cumulative Shareholder Return

The following graph compares cumulative total stockholder return on our common stock with the S&P Composite 500 Stock Index (S&P 500 Index) and an industry index, the S&P Financial Composite Index (S&P 500 Financials Index), for the period from December 31, 2003 to December 31, 2008. The graph assumes an initial investment of $100 in common stock of the specified securities. The cumulative returns include stock price appreciation and assume full reinvestment of dividends. The stock price performance on the graph below is not necessarily indicative of future performance.

	2003	2004	2005	2006	2007	2008
Capital One	100.00	137.40	140.97	125.34	77.11	52.03
S&P 500 Index	100.00	110.88	116.32	134.69	142.09	89.52
S&P 500 Financials Index	100.00	110.91	118.03	140.68	114.47	51.15

The remaining information required by Item 5 is included under the following:

Table of Contents

Item 6. ***Selected Financial Data***

(Dollars in millions, Except Per Share Data)	2008	2007 [1]	2006[1][5]	2005[1][4]	2004 [1]	Five Year Compound Growth Rate
Income Statement Data:						
Interest income	$ 11,112.0	$ 11,078.1	$ 8,164.7	$ 5,726.9	$ 4,794.4	18.31%
Interest expense	3,963.3	4,548.3	3,073.3	2,046.6	1,791.4	17.21%
Net interest income	7,148.7	6,529.8	5,091.4	3,680.3	3,003.0	18.94%
Provision for loan and lease losses	5,101.0	2,636.5	1,476.4	1,491.1	1,220.9	33.11%
Net interest income after provision for loan and lease losses	2,047.7	3,893.3	3,615.0	2,189.2	1,782.1	2.82%
Non-interest income	6,744.0	8,054.2	7,001.0	6,358.1	5,900.2	2.71%
Restructuring expense	134.5	138.2				N/A
Goodwill impairment charge	810.9					N/A
Other non-interest expense	7,264.7	7,939.8	6,943.6	5,718.3	5,322.2	6.42%
Income before income taxes and cumulative effect of accounting change	581.6	3,869.5	3,672.4	2,829.0	2,360.1	(24.43)%
Income taxes	497.1	1,277.8	1,246.0	1,019.9	816.6	(9.45)%
Income from continuing operations, net of tax	$ 84.5	$ 2,591.7	$ 2,426.4	$ 1,809.1	$ 1,543.5	(44.07)%
Loss from discontinued operations, net of tax[6]	(130.5)	(1,021.4)	(11.9)			N/A
Net income (loss)	$ (46.0)	$ 1,570.3	$ 2,414.5	$ 1,809.1	$ 1,543.5	(149.53)%
Net income (loss) available to common shareholders	(78.7)	1,570.3	2,414.5	1,809.1	1,543.5	(155.14)%
Dividend payout ratio	722.06%	2.68%	1.34%	1.52%	1.66%	236.91%
Per Common Share:						
Basic earnings per common share:						
Income from continuing operations, net of tax	$ 0.14	$ 6.64	$ 7.84	$ 6.98	$ 6.55	(53.66)%
Loss from discontinued operations, net of tax[6]	(0.35)	(2.62)	(0.04)			N/A
Net income (loss) per common share	$ (0.21)	$ 4.02	$ 7.80	$ 6.98	$ 6.55	(150.26)%
Diluted earnings per common share:						
Income from continuing operations, net of tax	$ 0.14	$ 6.55	$ 7.65	$ 6.73	$ 6.21	(150.80)%

26

Table of Contents

(Dollars in millions, Except Per Share Data)	2008	2007 [1]	2006[1][5]	2005[1][4]	2004 [1]	Five Year Compound Growth Rate
Loss from discontinued operations, net of tax[6]	(0.35)	(2.58)	(0.03)			N/A
Net income (loss) per common share	$ (0.21)	$ 3.97	$ 7.62	$ 6.73	$ 6.21	(53.16)%
Dividends paid per common share	1.50	0.11	0.11	0.11	0.11	N/A
Book value as of year-end	68.38	65.18	61.56	46.97	33.99	(1.27)%
Selected Year-End Reported Balances[3]:						
Loans held for investment	$ 101,017.8	$ 101,805.0	$ 96,512.1	$ 59,847.7	$ 38,215.6	21.46%
Allowance for loan and lease losses	4,524.0	2,963.0	2,180.0	1,790.0	1,505.0	24.62%
Total assets	165,878.4	150,499.1	144,360.8	88,701.4	53,747.3	25.28%
Interest-bearing deposits	97,326.9	71,714.6	73,913.9	43,092.1	25,636.8	30.58%
Total deposits	108,620.8	82,761.2	85,562.0	47,933.3	25,636.8[2]	33.48%
Borrowings	23,159.9	37,491.2	29,876.8	22,278.1	16,511.8	7.00%
Stockholders equity	26,612.4	24,294.1	25,235.2	14,128.9	8,388.2	25.97%
Selected Average Reported Balances[3]:						
Loans held for investment	$ 98,970.9	$ 93,541.8	$ 63,577.3	$ 40,734.2	$ 34,265.7	23.63%
Allowance for loan and lease losses	3,266.8	2,182.7	1,791.2	1,482.9	1,473.0	17.27%
Average earning assets	133,083.6	121,420.4	84,086.7	55,537.0	46,655.7	23.32%
Total assets	156,226.4	144,999.1	95,254.7	61,360.5	50,648.1	25.27%
Interest-bearing deposits	82,735.6	73,764.9	45,592.4	28,370.7	24,313.3	27.75%
Total deposits	93,507.6	85,211.6	50,526.8	29,019.7	24,313.3[2]	30.92%
Borrowings	31,096.5	30,101.5	24,451.7	18,031.9	15,723.6	14.61%
Stockholders equity	25,277.8	25,203.1	16,203.4	10,594.3	7,295.5	28.21%
Reported Metrics[3]:						
Revenue margin	10.44%	12.01%	14.38%	18.08%	19.08%	(11.36)%
Net interest margin	5.37	5.38	6.05	6.63	6.44	(3.56)%
Risk adjusted margin	7.83	10.40	12.71	15.47	16.31	(13.66)%
Delinquency rate	4.37	3.66	2.74	3.14	3.85	2.57%
Net charge-off rate	3.51	2.10	2.21	3.55	3.78	(1.42)%
Return on average assets	0.05	1.79	2.55	2.95	3.05	(55.35)%
Return on average equity	0.33	10.28	14.97	17.08	21.16	(56.38)%
Average equity to average assets	16.18	17.38	17.01	17.27	14.40	2.36%
Non-interest expense as a % of average loans held for investment[7]	7.48	8.64	10.92	14.04	15.53	(13.60)%
Efficiency ratio [7]	52.29	54.44	57.42	56.96	59.78	(0.56)

Table of Contents

(Dollars in millions, Except Per Share Data)	2008	2007 (1)	2006(1)(5)	2005(1)(4)	2004 (1)	Five Year Compound Growth Rate
Allowance as a % of loans held for investment	4.48	2.91	2.26	2.99	3.94	2.60%
Managed Metrics(3):						
Revenue margin	9.39%	9.85%	10.66%	12.45%	12.89%	(6.14)%
Net interest margin	6.37	6.46	6.88	7.80	7.88	(4.16)%
Risk adjusted margin	5.81	7.40	8.23	8.76	9.03	(8.45)%
Delinquency rate	4.49	3.87	3.02	3.24	3.82	3.28%
Net charge-off rate	4.35	2.88	2.84	4.25	4.41	(0.27)%
Return on average assets	0.04	1.33	1.70	1.72	1.73	(30.24)%
Non-interest expense as a % of average loans held for investment(7)	5.01	5.58	6.24	6.71	7.22	(7.06)%
Efficiency ratio (7)	43.14	47.30	50.17	46.81	49.01	(2.52)%
Average loans held for investment	$ 147,812.3	$ 144,727.0	$ 111,328.6	$ 85,265.0	$ 73,711.7	14.93%
Average earning assets	$ 179,348.1	$ 170,496.1	$ 129,812.8	$ 98,097.2	$ 84,240.3	16.31%
Year-end loans held for investment	$ 146,936.8	$ 151,362.4	$ 146,151.3	$ 105,527.5	$ 79,861.3	12.97%
Year-end total loan accounts	45.4	49.1	50.0	49.7	48.6	0.63%

(1) Prior period amounts have been reclassified to conform with current period presentation.
(2) Non-interest bearing deposits for the year 2004 were included in other liabilities.
(3) Based on continuing operations.
(4) On November 16, 2005, the Company acquired 100% of the outstanding common stock of Hibernia Corporation for total consideration of $5.0 billion.
(5) On December 1, 2006, the Company acquired 100% of the outstanding common stock of North Fork Bancorporation for total consideration of $13.2 billion.
(6) Discontinued operations related to the shutdown of mortgage origination operations of GreenPoint s wholesale mortgage banking unit in 2007.
(7) Excludes restructuring expenses and goodwill impairment charges.

Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

I. Introduction

Capital One Financial Corporation (the Corporation) is a diversified financial services company whose banking and non-banking subsidiaries market a variety of financial products and services. The Corporation s principal subsidiaries are:

- Capital One Bank, (USA), National Association (COBNA) which currently offers credit and debit card products, other lending products and deposit products.

- Capital One, National Association (CONA) which offers a broad spectrum of banking products and financial services to consumers, small businesses and commercial clients.

The Corporation and its subsidiaries are hereafter collectively referred to as the Company .

The Company continues to deliver on its strategy of combining the power of national scale lending and local scale banking. As of December 31, 2008, the Company had $108.6 billion in deposits and $146.9 billion in managed loans outstanding.

The Company s earnings are primarily driven by lending to consumers and commercial customers and by deposit-taking activities which generate net interest income, and by activities that generate non-interest income, including the sale and servicing of loans and providing fee-based services to customers. Customer usage and payment patterns, credit quality, levels of marketing expense and operating efficiency all affect the Company s profitability.

The Company s primary expenses are the costs of funding assets, provision for loan and lease losses, operating expenses (including associate salaries and benefits, infrastructure maintenance and enhancements, and branch operations and expansion costs), marketing expenses, and income taxes.

Table of Contents

During 2008, the Corporation completed several reorganizations and consolidations to streamline operations and regulatory relationships. On January 1, Capital One Auto Finance Inc. (COAF) moved from a direct subsidiary of the Corporation to become a direct operating subsidiary of CONA. In connection with the COAF move, one of COAF s direct operating subsidiaries, Onyx Acceptance Corporation (Onyx), became a direct subsidiary of the Corporation. On March 1, the Corporation converted Capital One Bank from a Virginia-state chartered bank to a national association, Capital One Bank (USA), National Association (COBNA). On March 8, Superior Savings of New England, N.A. (Superior) merged with and into CONA. Both COBNA and CONA are primarily regulated by the Office of the Comptroller of the Currency (the OCC). In May 2008, we consolidated the business and operations of two registered broker-dealers, Capital One Securities, LLC (dba Capital One Investments, LLC) and Capital One Investment Services Corporation (formerly NFB Investment Services Corporation), into Capital One Investments Services Corporation. In addition, in May 2008, we consolidated the business and operations of three insurance agencies, Capital One Agency Corp., GreenPoint Agency, Inc. and Hibernia Insurance Agency, LLC into Green Point Agency, Inc., which is now known as Capital One Agency LLC.

During the first quarter of 2008, the Company reorganized its National Lending sub-segments. Segment and sub-segment results have been restated for all periods presented. The National Lending segment consists of the following sub-segments:

- U.S. Card sub-segment which consists of the Company s domestic credit card business, including small business credit cards, and the installment loan businesses.

- Other National Lending sub-segment which includes the Company s auto finance and international lending sub-segments.

On December 4, 2008, the Company announced its intention to acquire Chevy Chase Bank F.S.B., the largest retail depository institution in the Washington, D.C. region in a cash and stock transaction valued at approximately $520 million. On February 13, 2009, the Company received approval from the Federal Reserve to acquire all of the shares of Chevy Chase Bank F.S.B. and certain of its subsidiaries. The Company expects the transaction to close in the first quarter of 2009.

During 2007, Capital One F.S.B. and North Fork Bank merged with and into CONA.

During 2007, the Company shut down the mortgage origination operations of its wholesale mortgage banking unit, GreenPoint Mortgage (GreenPoint), an operating subsidiary of CONA. Additional information can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 2.

II. Critical Accounting Estimates

The Notes to the Consolidated Financial Statements contain a summary of the Company s significant accounting policies, including a discussion of recently issued accounting pronouncements. Several of these policies are considered to be more critical to the portrayal of the Company s financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. Areas with significant judgment and/or estimates or that are materially dependent on management judgment include: fair value measurements including assessments of other-than-temporary impairments of securities available for sale; determination of the level of allowance for loan and lease losses; valuation of goodwill and other intangibles; finance charge, interest and fee revenue recognition; valuation of mortgage servicing rights; valuation of representation and warranty reserves; valuation of retained interests from securitization transactions; recognition of customer reward liability; treatment of derivative instruments and hedging activities; and accounting for income taxes.

Additional information about accounting policies can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 1.

Fair Value Measurements

Certain financial instruments are reported under generally accepted accounting principles, or GAAP, at fair value. The estimated fair value of other financial instruments not recorded at fair value must be disclosed. Securities available for sale, derivatives, mortgage servicing rights and retained interest in securitizations are financial instruments recorded at fair value on a recurring basis. Additionally, from time to time, we may be required to record at fair value other financial instruments on a nonrecurring basis, such as loans held for investment and mortgage loans held for sale. We include in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 12 information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and impact to earnings.

Additionally, for financial instruments not recorded at fair value we disclose the estimate of their fair value.

Effective January 1, 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157) for all financial assets and liabilities and for nonfinancial assets and liabilities measured at fair value on a recurring basis. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which prioritizes the valuation inputs into three broad levels. Based on the underlying inputs, each fair value measurement in its entirety is reported in one of the three levels. These levels are:

Level 1 Valuation is based upon quoted prices for identical instruments traded in active markets. Level 1 assets and liabilities include debt and equity securities traded in an active exchange market, as well as U.S. Treasury securities.

Table of Contents

Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is determined using model-based techniques with significant assumptions not observable in the market. These unobservable assumptions reflect the Company s own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of third party pricing services, option pricing models, discounted cash flow models and similar techniques.

SFAS 157 requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. When available, we use quoted market prices to measure fair value. If market prices are not available, fair value measurement is based upon models that use primarily market-based or independently-sourced market parameters, including interest rate yield curves, prepayment speeds, option volatilities and currency rates. When market observable inputs for model-based valuation techniques may not be readily available, we are required to make judgments about assumptions market participants would use in estimating the fair value of the financial instrument.

The extent of management judgment involved in measuring the fair value of financial instruments is dependent upon the availability of quoted prices or observable market data. For financial instruments that have quoted prices in active markets or whose fair value is measured using data observable in the market, there is minimal management judgment involved in measuring fair value. When quoted prices or observable market data is not fully available, management judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of quoted prices or observable market data. For example, an increase in dislocation and corresponding decrease in new issuance and trading volumes could result in observable market data becoming unavailable. When market data is not available, we use valuation techniques with assumptions that management believes other market participants would also use to estimate fair value.

Effective January 1, 2008, the Company adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value with changes in fair value included in current earnings. The election is made on specified election dates, can be made on an instrument by instrument basis, and is irrevocable. The initial adoption of SFAS 159 did not have a material impact on the consolidated earnings and financial position of the Company.

Determination of Allowance for Loan and Lease Losses

The allowance for loan and lease losses is maintained at the amount estimated to be sufficient to absorb probable principal losses, net of principal recoveries (including recovery of collateral), inherent in the existing reported loan portfolios. The provision for loan and lease losses is the periodic cost of maintaining an adequate allowance. The amount of allowance necessary is based on distinct allowance methodologies depending on the type of loans which include specifically identified criticized loans, migration analysis, forward loss curves and historical loss trends. In evaluating the sufficiency of the allowance for loan and lease losses, management takes into consideration many factors including, but not limited to: recent trends in delinquencies and charge-offs including bankrupt, deceased and recovered amounts; forecasting uncertainties and size of credit risks; the degree of risk inherent in the composition of the loan portfolio; economic conditions; legal and regulatory guidance; credit evaluations and underwriting policies; seasonality; and the value of collateral supporting the loans. To the extent credit experience is not indicative of future performance or other assumptions used by management do not prevail, loss experience could differ significantly, resulting in either higher or lower future provision for loan losses, as applicable. The evaluation process for determining the adequacy of the allowance for loan and lease losses and the periodic provisioning for estimated losses is undertaken on a quarterly basis, but may increase in frequency should conditions arise that would require the Company s prompt attention. Conditions giving rise to such action are business combinations or other acquisitions or dispositions of large quantities of loans, dispositions of non-performing and marginally performing loans by bulk sale or any development which may indicate a significant trend.

Commercial and small business loans are considered to be impaired in accordance with the provisions of SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, (SFAS 114) when it is probable that all amounts

Table of Contents

due in accordance with the contractual terms will not be collected. Specific allowances are determined in accordance with SFAS 114. Impairment is measured based on the present value of the loan s expected cash flows, the loan s observable market price or the fair value of the loan s collateral.

For purposes of determining impairment, consumer loans are collectively evaluated as they are considered to be comprised of large groups of smaller-balance homogeneous loans and therefore are not individually evaluated for impairment under the provisions of SFAS 114.

Troubled debt restructurings (TDR) occur when the Company agrees to significantly modify the original terms of a loan due to the deterioration in the financial condition of the borrower. The Company modified an immaterial amount of loans under TDRs in 2008 and 2007.

As of December 31, 2008 and 2007, the balance in the allowance for loan and lease losses was $4.5 billion and $3.0 billion, respectively.

Valuation of Goodwill and Other Intangible Assets

As of December 31, 2008 and 2007, goodwill of $12.0 billion and $12.8 billion and net intangibles of $0.9 billion and $1.1 billion, respectively, were included in the Consolidated Balance Sheet.

Goodwill and other intangible assets, primarily core deposit intangibles, reflected on the Consolidated Balance Sheet arose from acquisitions accounted for under the purchase method. At the date of acquisition, the Company recorded the assets acquired and liabilities assumed at fair value. The excess of the cost of the acquired business over the fair value of the net assets acquired is recorded on the balance sheet as goodwill. The cost includes the consideration paid and all direct costs associated with the acquisition. Indirect costs relating to the acquisition were expensed when incurred.

Goodwill

In accordance with the requirements of SFAS No. 142, *Goodwill and Other Intangible Assets*, (SFAS 142) goodwill is not amortized but is tested for impairment at the reporting unit level, which is at the operating segment level or one level below an operating segment. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Goodwill is required to be tested for impairment annually and between annual tests if events or circumstances change, such as adverse changes in the business climate, that would more likely than not reduce the fair value of the reporting unit below its carrying value.

Goodwill is assigned to one or more reporting units at the date of acquisition. The Company s reporting units are Local Banking, U.S. Card, Auto Finance, and International. The goodwill impairment test, performed at October 1 of each year, is a two-step test. The first step identifies whether there is potential impairment by comparing the fair value of a reporting unit to the carrying amount, including goodwill. If the fair value of a reporting unit is less than its carrying amount, the second step of the impairment test is required to measure the amount of any impairment loss.

For the 2008 annual impairment test, the fair value of reporting units was calculated using a discounted cash flow analysis, a form of the income approach, using each reporting unit s internal five year forecast and a terminal value calculated using a growth rate reflecting the nominal growth rate of the economy as a whole and appropriate discount rates for the respective reporting units. Cash flows were adjusted as necessary in order to maintain each reporting unit s equity capital requirements. Our discounted cash flow analysis required management to make judgments about future loan and deposit growth, revenue growth, credit losses, and capital rates. The cash flows were discounted to present value using reporting unit specific discount rates that are largely based on the Company s external cost of equity with adjustments for risk inherent in each reporting unit. Discount rates used for the reporting units ranged from 10.1% to 14.0%. The key inputs into the discounted cash flow analysis were corroborated with market data, where available, indicating that assumptions used were within a reasonable range of observable market data.

Based on the comparison of fair value to carrying amount, as calculated using the methodology summarized above, fair value exceeded carrying amount in the U.S. Card, International, and Local Banking reporting units as of the Company s annual testing date; therefore, the goodwill of those reporting units was considered not impaired, and the second step of impairment testing was unnecessary. However, all others factors held constant, a 7% decline in the fair value of the Local Banking reporting unit, a 19% decline in the fair value the U.S. Card reporting unit and a 5% decline in the fair value of the International reporting unit would have caused the carrying amount for those reporting units to be in excess of fair value which would require the second step to be performed. The Auto Finance reporting unit, with a $1.4 billion carrying amount of goodwill, failed the first step as fair value was less than carrying amount by $909.7 million. The deficit was primarily a result of a reduced estimate of the fair value of the Auto Finance reporting unit due to fourth quarter business decisions to scale back that business.

Table of Contents

The Auto Finance reporting unit was required to move to the second step of the goodwill impairment test which is used to measure the amount of impairment loss, if any. The second step compares the implied fair value of reporting unit goodwill to the carrying amount of that goodwill. If the carrying amount of the goodwill exceeds the implied fair value of the goodwill, an impairment loss is recorded for the excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. That is, an entity shall allocate the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. In the allocation of fair value of the Auto Finance reporting unit to its assets and liabilities, the Company assigned a $1.5 billion discount to the net carrying amount of its loans, largely due to the lack of liquidity and credit deterioration in the auto securitization market. The Company also assigned a $1.4 billion discount to the carrying amount of its liabilities, largely due to increased spreads resulting from the credit crisis. Based on the final results of the annual impairment test, a loss of $810.9 million was recognized for the year-ended December 31, 2008.

As part of the annual impairment test, the Company assessed its market capitalization based on the prior month average market price relative to the aggregate fair value of its reporting units and determined that any excess fair value in its reporting units at that time could be attributed to a reasonable control premium compared to historical control premiums seen in the industry. During the fourth quarter of 2008 and continuing into 2009, our stock price, along with the stock prices of others in the financial services industry, declined significantly resulting in a decline in our market capitalization subsequent to our annual goodwill impairment testing date. As a result of this decline, we reassessed and updated assumptions from our annual testing and concluded that while it is reasonable to consider market capitalization as one indicator of fair value of our reporting units, the Company does not believe the fourth quarter decline in our market capitalization resulted in any further goodwill impairment in 2008. We believe the fourth quarter 2008 decline in our market capitalization to be primarily attributable to the current lack of liquidity in the financial markets and to continuing economic deterioration with a corresponding decline in the fair value of the Company s tangible net assets that are also impacted by those factors, as reflected in the fair value disclosures in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 12, instead of a decline in the implied fair value of goodwill. However, we will continue to regularly monitor declines in our market capitalization in 2009, overall economic conditions and other events or circumstances that might result in an impairment of goodwill in the future.

Other Intangible Assets

Other intangible assets having finite useful lives are separately recognized and amortized over their estimated useful lives and reviewed for impairment. An impairment loss is recognized if the carrying amount of the intangible assets is not recoverable and its carrying amount exceeds its fair value. There were no impairment losses recognized for other intangible assets during the years ended December 31, 2008 and 2007.

Revenue Recognition

The Company recognizes earned finance charges and fee income on credit card loans according to the contractual provisions of the credit arrangements. When the Company does not expect full payment of finance charges and fees, it does not accrue the estimated uncollectible portion as income (hereafter the suppression amount). To calculate the suppression amount, the Company first estimates the uncollectible portion of credit card finance charge and fee receivables using a formula based on an estimate of future non-principal losses. This formula is consistent with that used to estimate the allowance related to expected principal losses on reported loans. The suppression amount is calculated by adding any current period change in the estimate of the uncollectible portion of finance charge and fee receivables to the amount of finance charges and fees charged-off (net of recoveries) during the period. The Company subtracts the suppression amount from the total finance charges and fees billed during the period to arrive at total reported revenue.

The amount of finance charges and fees suppressed were $1.9 billion and $1.1 billion for the years ended December 31, 2008 and 2007, respectively.

Nonperforming Assets

Nonperforming assets include nonaccrual loans, impaired loans, certain restructured loans on which interest rates or terms of repayment have been materially revised and foreclosed and repossessed assets.

Commercial loans, consumer real estate and auto loans are placed in nonaccrual status at 90 days past due or sooner if, in management s opinion, there is doubt concerning full collectibility of both principal and interest. All other consumer loans and small business credit card loans are not placed in nonaccrual status prior to charge-off.

For other consumer loans and commercial loans, the Company places loans in a non-accrual status, which prevents the accrual of further interest income, when a loan reaches a pre-determined delinquency status, generally 90 to 120 days past due.

Table of Contents

At the time a loan is placed on nonaccrual status, interest and fees accrued but not collected through the end of the previous quarter are systematically reversed and charged against income. Interest payments received on nonaccrual loans are applied to principal if there is doubt as to the collectibility of the principal; otherwise, these receipts are recorded as interest income. A loan remains in nonaccrual status until it is current as to principal and interest and the borrower demonstrates the ability to fulfill the contractual obligation.

Upon foreclosure or repossession, loans are adjusted, if necessary, to the estimated fair value of the underlying collateral and transferred to other assets, net of a valuation allowance for selling costs. We estimate market values primarily based on appraisals when available or quoted market prices on liquid assets.

Valuation of Mortgage Servicing Rights

Mortgage servicing rights (MSRs) are recognized at fair value when mortgage loans are sold in the secondary market and the right to service these loans are retained for a fee; changes in fair value are recognized in mortgage servicing and other income. The Company continues to operate the mortgage servicing business and to report the changes in the fair value of MSRs in continuing operations. To evaluate and measure fair value, the underlying loans are stratified based on certain risk characteristics, including loan type, note rate and investor servicing requirements. Fair value of the MSRs is determined using the present value of the estimated future cash flows of net servicing income. The Company uses assumptions in the valuation model that market participants use when estimating future net servicing income, including prepayment speeds, discount rates, default rates, cost to service, escrow account earnings, contractual servicing fee income, ancillary income and late fees. This model is highly sensitive to changes in certain assumptions. Different anticipated prepayment speeds, in particular, can result in substantial changes in the estimated fair value of MSRs. If actual prepayment experience differs from the anticipated rates used in the Company s model, this difference could result in a material change in MSR value.

As of December 31 2008 and 2007, the MSR balance was $150.5 million and $247.6 million, respectively.

Valuation of Representation and Warranty Reserve

The representation and warranty reserve is available to cover probable losses inherent with the sale of mortgage loans in the secondary market. In the normal course of business, certain representations and warranties are made to investors at the time of sale, which permit the investor to return the loan to the seller or require the seller to indemnify the investor for certain losses incurred by the investor while the loan remains outstanding. The evaluation process for determining the adequacy of the representation and warranty reserve and the periodic provisioning for estimated losses is performed for each product type on a quarterly basis. Factors considered in the evaluation process include historical sales volumes, aggregate repurchase and indemnification activity, and actual losses incurred. Quarterly changes to the representation and warranty reserve related to GreenPoint are reported as discontinued operations for all periods presented.

As of December 31, 2008 and 2007, the representation and warranty reserve was $140.2 million and $93.4 million, respectively, of which $122.2 million and $84.5 million were attributable to the discontinued wholesale mortgage origination business of GreenPoint. respectively.

Valuation of Retained Interests in Securitization Transactions

The Company s retained residual interests in off-balance sheet securitizations are recorded in accounts receivable from securitizations and are comprised of interest-only strips, retained senior tranches, retained subordinated tranches, cash collateral accounts, cash reserve accounts and unpaid interest and fees on the investors portion of the transferred principal receivables.

In accordance with SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SFAS 140), the Company removes loan receivables from its Consolidated Balance Sheet and records a gain on sale for securitization transactions that qualify as sales (off-balance sheet securitizations). The gain is recorded net of transaction costs and is based on the estimated fair value of the assets sold and assets retained or liabilities incurred. The related receivable is the interest-only strip, which is based on the present value of the estimated future cash flows from excess finance charges and past-due fees over the sum of the return paid to security holders, estimated contractual servicing fees and credit losses. Retained assets are recorded in accounts receivable from securitizations at estimated fair value. The Company s retained residual interests are generally restricted or subordinated to investors interests and their value is subject to substantial credit, repayment and interest rate risks on transferred assets if the off-balance sheet loans are not paid when due. As such, the interest-only strip and subordinated retained interests are classified as trading assets in accordance with SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* (SFAS 155), and changes in the estimated fair value are recorded in servicing and securitization income. Additionally, the Company may retain senior tranches in the securitization transactions which are considered to be investment grade securities and subject to a lower risk of loss. These senior tranches are also recorded in accounts receivable from securitizations at estimated fair value. The Company classifies senior retained tranches as available for sale securities in accordance with SFAS

No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115), and changes in the estimated fair value are recorded in other comprehensive income.

Table of Contents

The fair value of retained interest is highly sensitive to changes in certain assumptions. To the extent assumptions used by management do not prevail, the estimated fair value of retained interests could be materially impacted.

As of December 31, 2008 and 2007, accounts receivable from securitization totaled $6.34 billion and $4.72 billion, respectively. This balance consists of retained residual interests that are recorded at estimated fair value and totaled $2.30 billion and $2.26 billion at December 31, 2008 and 2007, respectively. The remaining balance relates to cash collections held at financial institutions that are expected to be returned to the Company on future distribution dates and principal collections accumulated for expected maturities of securitization transactions with a subsequent return of loans receivables.

Recognition of Customer Rewards Liability

The Company offers products, primarily credit cards, that provide program members with various rewards such as airline tickets, free or deeply discounted products or cash rebates, based on account activity. The Company establishes a rewards liability based on points earned which are ultimately expected to be redeemed and the average cost per point redemption. As points are redeemed, the rewards liability is relieved. The cost of reward programs is primarily reflected as a reduction to interchange income. The rewards liability will be affected over time as a result of changes in the number of account holders in the reward programs, the actual amount of points earned and redeemed the actual costs of the rewards, changes made by reward partners and changes that the Company may make to the reward programs in the future. To the extent assumptions used by management do not prevail, rewards costs could differ significantly, resulting in either a higher or lower future rewards liability, as applicable.

As of December 31, 2008 and 2007, the rewards liability was $1.4 billion and $1.3 billion, respectively.

Derivative Instruments and Hedging Activities

The Company utilizes certain derivative instruments to minimize significant unplanned fluctuations in earnings caused by interest rate and foreign exchange rate volatility. The Company s goal is to manage sensitivity to changes in rates by offsetting the repricing or maturity characteristics of certain assets and liabilities, thereby limiting the impact on earnings. The use of derivative instruments does expose the Company to credit and market risk. The Company manages credit risk through strict counterparty credit risk limits and/or collateralization agreements.

At inception, the Company determines if a derivative instrument meets the criteria for hedge accounting under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* as amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* (SFAS 133). Ongoing effectiveness evaluations are made for instruments that are designated and qualify as hedges. If the derivative does not qualify for hedge accounting, no assessment of effectiveness is needed by management.

Accounting for Income Taxes

The Company accounts for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes* (SFAS 109), recognizing the current and deferred tax consequences of all transactions that have been recognized in the financial statements using the provisions of the enacted tax laws. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109,* (FIN 48) effective January 1, 2007.

The calculation of the Company s income tax provision is complex and requires the use of estimates and judgments. When analyzing business strategies, the Company considers the tax laws and regulations that apply to the specific facts and circumstances for any transaction under evaluation. This analysis includes the amount and timing of the realization of income tax provisions or benefits. Management closely monitors tax developments in order to evaluate the effect they may have on its overall tax position and the estimates and judgments utilized in determining the income tax provision and records adjustments as necessary.

The Company records valuation allowances to reduce deferred tax assets to the amount that is more likely than not to be realized. In making this assessment, management analyzes future taxable income, reversing temporary differences and ongoing tax planning strategies. Should a change in circumstances lead to a change in judgment about the realizability of deferred tax assets in future years, the Company would adjust related valuation allowances in the period that the change in circumstances occurs, along with a corresponding increase or charge to income.

Table of Contents

For the years ended December 31, 2008 and 2007, the provision for income taxes on continuing operations was $0.5 billion and $1.3 billion, respectively, and as of December 31, 2008 and 2007, the valuation allowance was $67.7 million and $21.3 million, respectively.

III. Off-Balance Sheet Arrangements

The Company has various types of off-balance sheet arrangements that we enter into in the ordinary course of business. Off-balance sheet activities typically utilize special purpose entities (SPEs) that may be in the form of limited liability companies, partnerships or trusts. The SPEs raise funds by issuing debt to third party investors. The SPEs hold various types of financial assets whose cash flows are the primary source of repayment for the liabilities of the SPE. Investors only have recourse to the assets held by the SPE but may also benefit from other credit enhancements.

The Company s involvement in these arrangements can take many different forms, including securitization activities, servicing activities, the purchase or sale of mortgage-backed and other asset backed securities in connection with our investment portfolio, and loans to variable interest entities (VIEs) that hold debt, equity, real estate or other assets. In certain instances, the Company also provides guarantees to VIEs or holders of variable interests in VIEs. See Item 8. Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 13 Mortgage Servicing Rights; Note 18 Securitizations; Note 19 Commitments, Contingencies and Guarantees; and Note 20 Other Variable Interest Entities for more detail on the Company s involvement and exposure related to off-balance sheet arrangements.

Special Purpose Entities

A SPE is an entity in the form of a trust or other legal vehicle designed to fulfill a specific limited need of the company that was initially involved in the organization of the SPE. The primary use of SPEs is to obtain liquidity and favorable capital treatment by securitizing certain assets of the Company. In a securitization, a company transfers assets to an SPE and receives cash proceeds for the assets that have been transferred upon the issuance of debt and equity instruments, certificates or other notes of indebtedness. The transferred assets and the related debt issuances are recorded on the balance sheet of the SPE and are not reflected on the company s balance sheet, assuming the transfer satisfies the sale criteria of SFAS 140. Investors usually have recourse to the assets in the SPE and may also benefit from other credit enhancements, such as a collateral account or overcollateralization in the form of excess assets in the SPE, or from other liquidity guarantees. The SPE can typically obtain a more favorable credit rating from rating agencies than the transferor could obtain for its own debt issuances, resulting in less expensive financing costs. The SPE may also enter into derivative contracts in order to convert the yield or currency of the underlying assets to match the needs of the SPE investors, or to limit or change the credit risk of the SPE. The Company may be the provider of certain credit enhancements as well as the counterparty to any related derivative contracts.

Qualifying SPEs

Qualifying special purpose entities (QSPEs) are a special class of SPEs which are defined in SFAS 140. These SPEs have significant limitations on the types of assets and derivative instruments they may own and may not actively manage their assets through discretional sales and are generally limited to making decisions inherent in servicing activities and issuance of liabilities. QSPEs are passive entities designed to purchase assets and pass through the cash flows from the transferred assets to the investors of the QSPE. QSPEs are generally exempt from consolidation by the transferor of assets to the QSPE and any investor or counterparty.

In April 2008, the FASB voted to eliminate QSPEs from the accounting guidance. On September 15, 2008, the FASB issued exposure drafts to amend SFAS 140 and FASB Interpretation No. 46 (Revised 2003), *Consolidation of Variable Interest Entities* (FIN 46(R)). The two proposed Statements would significantly change accounting for transfers of financials assets, due to elimination of the concept of a QSPE, and would change the criteria for determining whether to consolidate a VIE. The proposals are currently in a public comment period and are subject to change. As the proposals stand, however, the change would have a significant impact on the Company s consolidated financial statements as a result of the loss of sales treatment for assets previously sold to a QSPE, as well as for future sales. As of December 31, 2008, the total assets of QSPEs to which the Company has transferred and received sales treatment were $45.9 billion.

Variable Interest Entities

VIEs are entities defined in FIN 46(R), and are entities that have either a total equity investment that is insufficient to permit the entity to finance its activities without additional subordinated financial support or whose equity investors lack the characteristics of a controlling financial interest (i.e.,

35

ability to make significant decisions through voting rights, right to receive the expected residual returns of the entity, and obligation to absorb the expected losses of the entity). Investors that finance the VIE through debt or equity interests, or other counterparties that provide other forms of support, such as guarantees, subordinated fee arrangements, or certain types of derivative contracts, are variable interest holders in the entity. The variable interest holder, if any, that will absorb a majority of the entity s expected losses, receive a majority of the entity s expected residual returns, or both, is deemed to be the primary beneficiary and must consolidate the VIE. Consolidation under FIN 46(R) is based on expected losses and residual returns, which consider various scenarios on a probability-weighted basis. Consolidation of a VIE is determined based primarily on variability generated in scenarios that are considered most likely to occur, rather than based on scenarios that are considered more remote. Certain variable interests may absorb significant amounts of losses or residual returns contractually, but if those scenarios are considered very unlikely to occur, they may not lead to consolidation of the VIE.

All these facts and circumstances are taken into consideration when determining whether the Company has variable interest that would deem it to be the primary beneficiary and require consolidation of the VIE or otherwise rise to the level where disclosure would provide useful information to the users of the Company s financial statements. In some cases, it is qualitatively clear based on the extent of the Company s involvement or the seniority of its investments that the Company is not the primary beneficiary of the VIE. In other cases, a more detailed and quantitative analysis may be required to make such a determination.

Securitization Activities

The securitization of loans has been a significant source of liquidity for the Company. The Company typically uses QSPEs to securitize its credit card loans. QSPEs are generally exempt from consolidation by the transferor of assets to the QSPE and any investor or counterparty.

Recourse Exposure

The Company retains residual interests in the trusts as credit enhancements to support the credit quality of the receivables transferred to the trust. The Company s retained residual interests are generally restricted or subordinated to investors interests and their value is subject to substantial credit, repayment and interest rate risks on the transferred financial assets. The value of the retained residual interests represents the Company s only exposure to loss resulting from its continuing involvement in the trusts. The investors and the trusts have no recourse to the Company s assets if the off-balance sheet loans are not paid when due. The Company has not provided any financial or other support during the periods presented that it was not previously contractually required to provide. The Company s retained residual interests in the off-balance sheet securitizations are recorded in accounts receivable from securitizations and are comprised of interest-only strips, retained senior tranches, retained subordinated interests, cash collateral accounts, cash reserve accounts and unpaid interest and fees on the investors portion of the transferred principal receivables. See Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 18 for quantitative information regarding retained interests.

Collections and Amortization

Collections of interest and fees received on securitized receivables are used to pay interest to investors, servicing and other fees, and are available to absorb the investors share of credit losses. Amounts collected in excess of that needed to pay the above amounts are remitted, in general, to the Company. Under certain conditions, some of the cash collected may be retained to ensure future payments to investors. See Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 18 for quantitative information regarding revenues, expenses and cash flows that arise from securitization transactions.

Maturity terms of the existing securitizations vary from 2009 to 2025 and, for revolving securitizations, have accumulation periods during which principal payments are aggregated to make payments to investors. As payments on the loans are accumulated and are no longer reinvested in new loans, the Company s funding requirements for loans increase accordingly. The Company believes that it has the ability to continue to utilize securitization arrangements as a source of liquidity; however, a significant reduction, termination or change in sale accounting for the Company s off-balance sheet securitizations could require the Company to draw down existing liquidity and/or to obtain additional funding through the issuance or recognition of secured borrowings or unsecured debt, the raising of additional deposits or the slowing of asset growth to offset or to satisfy liquidity needs.

Securitization transactions may amortize earlier than scheduled due to certain early amortization triggers, which could require the Company to fund spread accounts, reduce the value of its retained residual interests and ultimately require the off-balance sheet loans to be recorded on the Company s balance sheet and accelerate the need for alternative funding. Additionally, early amortization of securitization structures would require the Company to record higher reserves for loan losses and would also have a significant impact on the ability of the Company to meet regulatory capital adequacy requirements. As of December 31, 2008, no early amortization events related to the Company s off-balance sheet securitizations have occurred.

Table of Contents

The amounts of investor principal from off-balance sheet loans as of December 31, 2008 that are expected to amortize into the Company s loans, or be otherwise paid over the periods indicated, are summarized in Table 12. Of the Company s total managed loans, 31% and 33% were included in off-balance sheet securitizations for the years ended December 31, 2008 and 2007, respectively.

Servicing Activities

The Company services mortgage loans that have been sold through either whole loan sales or securitizations with servicing retained. MSRs, are recognized when mortgage loans are sold in the secondary market and the right to service these loans are retained for a fee, and are carried at fair value; changes in fair value are recognized in mortgage servicing and other. The Company may enter into derivatives to economically hedge changes in fair value of MSRs. The Company typically does not have any continuing involvement other than its right to service the loans and the Company does not hold subordinate residual interests or enter into other guarantees or liquidity agreements with these structures. The Company records the MSR at estimated fair value and has no other loss exposure over and above the recorded fair value. See Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 13 for quantitative information regarding MSRs.

Community Development Activities

As part of its community reinvestment initiatives, the Company invests in private investment funds that make investments in common stock of VIEs or provide debt financing to VIEs to support multi-family affordable housing properties. The Company receives affordable housing tax credits for these investments. The activities of these entities are financed with a combination of invested equity capital and debt. The Company is not required to consolidate these entities because it does not absorb the majority of the entities expected losses nor does it receive a majority of the entities expected residual returns. The Company records its interests in these unconsolidated VIEs in loans held for investment, other assets and other liabilities. The Company s maximum exposure to these entities is limited to its variable interests in the entities and the creditors of the VIEs have no recourse to the general credit of the Company. The Company has not provided additional financial or other support during the period that it was not previously contractually required to provide. See Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 20 for quantitative information regarding Other Variable Interest Entities.

The Company holds variable interests in entities (Investor Entities) that invest in community development entities (CDEs) that provide debt financing to businesses and non-profit entities in low-income and rural communities. Investments of the consolidated Investor Entities are also variable interests of the Company. The activities of the Investor Entities are financed with a combination of invested equity capital and debt. The activities of the CDEs are financed solely with invested equity capital. The Company receives federal and state tax credits for these investments. The Company consolidates the VIEs of which it absorbs the majority of the entities expected losses or receives a majority of the entities expected residual returns. The assets of the entities consolidated by the Company at December 31, 2008 and December 31, 2007 were approximately $189.7 million and $102.1 million, respectively. The assets and liabilities of these consolidated VIEs were recorded in cash, loans held for investment, interest receivable, other assets and other liabilities. In addition to the amounts above, the Company had involvement with entities where we held a significant variable interest in the VIE but were not deemed to be the primary beneficiary as the Company would not absorb the majority of expected losses or receive a majority of the expected residual returns. Accordingly, these entities were not consolidated by the Company. The assets of the entities that the Company held a significant variable interest in but was not required to consolidate at December 31, 2008 and December 31, 2007 were approximately $46.6 million and $12.0 million, respectively. The Company records its interests in these unconsolidated VIEs in loans held for investment and other assets. The Company s maximum exposure to these entities is limited to its variable interests in the entities. The creditors of the VIEs have no recourse to the general credit of the Company. The Company has not provided additional financial or other support during the period that it was not previously contractually required to provide. See Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 20 for quantitative information regarding Other Variable Interest Entities.

Table of Contents

Trust Preferred Securities

The Company has raised financing through the issuance of trust preferred securities. In these transactions, the Company forms a statutory business trust and owns all of the voting equity shares of the trust. The trust issues preferred equity securities to third-party investors and invests the gross proceeds in junior subordinated deferrable interest debentures issued by the Company. These trusts have no assets, operations, revenues or cash flows other than those related to the issuance, administration, and repayment of the preferred equity securities held by third-party investors. These trusts obligations are fully and unconditionally guaranteed by the Company.

Because the sole asset of the trust is a receivable from the Company, the Company is not permitted to consolidated the trusts under FIN 46R, even though the Company owns all of the voting equity shares of the trust, has fully guaranteed the trusts obligations, and has the right to redeem the preferred securities in certain circumstances. The Company recognizes the subordinated debentures on its balance sheet as long-term liabilities. See Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 8 for quantitative information regarding Deposits and Other Borrowings.

IV. Reconciliation to GAAP Financial Measures

The Company s consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) are referred to as its reported financial statements. Loans included in securitization transactions which qualify as sales under GAAP have been removed from the Company s reported balance sheet. However, servicing fees, finance charges, and other fees, net of charge-offs, and interest paid to investors of securitizations are recognized as servicing and securitizations income on the reported income statement.

The Company s managed consolidated financial statements reflect adjustments made related to effects of securitization transactions qualifying as sales under GAAP. The Company generates earnings from its managed loan portfolio which includes both the on-balance sheet loans and off-balance sheet loans. The Company s managed income statement takes the components of the servicing and securitizations income generated from the securitized portfolio and distributes the revenue and expense to appropriate income statement line items from which it originated. For this reason, the Company believes the managed consolidated financial statements and related managed metrics to be useful to stakeholders.

As of and for the year ended December 31, 2008

(Dollars in millions)	Total Reported	Securitization Adjustments[1]	Total Managed[2]
Income Statement Measures[3]			
Net interest income	$ 7,149	$ 4,273	$ 11,422
Non-interest income	6,744	(1,327)	5,417
Total revenue	13,893	2,946	16,839
Provision for loan losses	5,101	2,946	8,047
Net charge-offs	$ 3,478	$ 2,946	$ 6,424
Balance Sheet Measures			
Loans held for investment	$ 101,018	$ 45,919	$ 146,937
Total assets	165,913	43,962	209,875
Average loans held for investment	98,971	48,841	147,812
Average earning assets	133,084	46,264	179,348
Average total assets	156,268	47,262	203,530
Delinquencies	$ 4,418	$ 2,178	$ 6,596

(1) Income statement adjustments for the year ended December 31, 2008 reclassify the net of finance charges of $5,563.4 million, past due fees of $933.6 million, other interest income of $(158.1) million and interest expense of $2,065.6 million; and net charge-offs of $2,946.8 million from non-interest income to net interest income and provision for loan losses, respectively.

(2)

The managed loan portfolio does not include auto loans which have been sold in whole loan sale transactions where the Company has retained servicing rights.

(3) Based on continuing operations.

V. Management Summary and Business Outlook

Management Summary

The following discussion provides a summary of 2008 results compared to 2007 results and 2007 results compared to 2006 results on a continuing operations basis, unless otherwise noted. Each component is discussed in further detail in subsequent sections of this analysis. The results of the Company s mortgage origination operations of GreenPoint, which was acquired as part of the North Fork Bancorporation acquisition in December 2006, are accounted for as discontinued operations.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

The Company had a net loss of $46.0 million, or $(0.21) per share (diluted) for the year ended December 31, 2008, compared to net income of $1.6 billion, or $3.97 per share (diluted) for the year ended December 31, 2007. Net loss for 2008 included an after-tax loss from discontinued operations of $130.5 million, or $(0.35) per share (diluted), compared to an after-tax loss from discontinued operations of $1.0 billion, or $(2.58) per share (diluted) in 2007.

Income from continuing operations for 2008 was $84.5 million, a decrease of $2.5 billion, or 96.7% from $2.6 billion in 2007. Diluted earnings per share from continuing operations for 2008 was $0.14, a decrease of 97.9% from $6.55 in 2007.

2008 Summary of Significant Events

U.S. Economic Recession and Credit Deterioration

The U.S. economic recession has impacted the Company in multiple ways during the year. Most notably we have seen significant deterioration in credit performance. As the recession deepened, the Company responded by fortifying its balance sheet, exiting the riskiest areas we operated in and reducing costs as appropriate. The following demonstrates how the U.S. economic recession and credit deterioration, and the Company s actions to anticipate and respond to economic worsening, have impacted the Company:

- Increased managed charge-off rate and managed delinquency rate by 147 basis points and 62 basis points, respectively, to 4.35% and 4.49%, respectively,
- Increased the allowance for loan and lease losses by $1.6 billion to $4.5 billion, increasing the coverage ratio of allowance as a percentage of loans held for investment by 157 basis points to 4.48%,
- Increased our provision for loan and lease losses by $2.5 billion to $5.1 billion,
- Reduced the fair value of the interest-only strips by $224.8 million,
- Revenue suppression, which is the amounts billed to customers but not recognized as revenue, increased to $1.9 billion from $1.1 billion,
- Experienced a $4.4 billion reduction in managed loans held for investment, due to weaker spending and loan demand from credit-worthy customers, tightening underwriting, an exit from lending activities not resilient to the economic downturn and an increase in charge-offs,
- Deposit growth was primarily invested in high-quality agency mortgage backed securities and AAA-rated securities backed by consumer loans. Increasing our securities available for sale by $11.2 billion to $31.0 billion.

U.S. Treasury Department s Capital Purchase Program Participation

On November 14, 2008 the Company entered into an agreement (the Securities Purchase Agreement) to issue 3,555,199 Fixed Rate Cumulative Perpetual Preferred Shares, Series A, par value $0.01 per share (the Series A Preferred Stock), to the United States Department of the Treasury (U.S. Treasury) as part of the Company s participation in the U.S. Treasury s Troubled Asset Relief Program Capital Purchase Program (CPP), having a liquidation amount per share equal to $1,000. The Series A Preferred Stock pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. The Company may not redeem the Series A Preferred Stock during the first three years except with the proceeds from a qualified equity offering. The ARRA includes provisions that would allow the Company to redeem the Series A

Preferred Stock using proceeds other than those received from a qualified equity offering under certain circumstances and with regulatory approval. After three years, the Company may, at its option, redeem the Series A Preferred Stock at the liquidation amount plus accrued and unpaid dividends. The Series A Preferred Stock is generally non-voting.

In addition, the Company issued Warrant to purchase 12,657,960 of the Company s common shares to the U.S. Treasury as part of the Securities Purchase Agreement. The Warrant have an exercise price of $42.13 per share. The Warrant expire ten years from the issuance date. If, on or prior to December 31, 2009, the Company receives aggregate gross cash proceeds of not less than the purchase price of the Series A Preferred Stock from one or more qualified equity offerings announced after October 13, 2008, the number of shares of common stock issuable pursuant to the U.S. Treasury s exercise of the Warrant will be reduced by one-half of the original number of shares, taking into account all adjustments, underlying the Warrant. Pursuant to the Securities Purchase Agreement, the U.S. Treasury has agreed not to exercise voting power with respect to any shares of common stock issued upon exercise of the Warrants.

The Company received proceeds of $3.55 billion for the Series A Preferred Stock and the Warrant. The Company allocated the proceeds based on a relative fair value basis between the Series A Preferred Stock and the Warrant, recording $3.06 billion and $491.5 million, respectively. The fair value of the preferred stock was estimated using independent quotes from third party sources who considered the structure, subordination and size of the preferred stock issuance in comparison to the trust preferred securities issued by special purpose trusts established by the Company. Fair value of the stock warrant was estimated using a pricing model with the most significant assumptions being the forward dividend yield and implied volatility of the Company s stock price. The $3.06 billion of Series A Preferred Stock is net of a discount of $491.5 million. The discount will be accreted to the $3.55 billion liquidation preference amount over a five year period. The accretion of the discount and dividends on the preferred stock reduce net income available to common shareholders.

The Company is subject to a number of restrictions as a result of participation in the CPP. Among these are restrictions on dividend payments to common shareholders and restrictions on share repurchases. If the Series A Preferred Stock has not been redeemed by November 14, 2011 or the U.S. Treasury has not transferred the Series A Preferred Stock to a third party, the consent of the U.S Treasury will be required to (1) declare or pay any dividend or make any distribution on the Company s common stock (other than regular quarterly cash dividends of not more than $0.375 per share of common stock) or (2) redeem, purchase or acquire any shares of our common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances specified in the Securities Purchase Agreement.

The Company is considered well-capitalized under the applicable capital adequacy guidelines and did not need to participate in the CPP. However, the Company concluded, following careful analysis and consultation with regulators, that the CPP was an important step in supporting the financial and economic stability of the U.S. and that the U.S. Treasury s investment provided an attractive alternative source of capital which we can use for the benefit of our customers and investors.

OCC Minimum Payment Rules

In March 2008, COBNA converted from a Virginia state-charted bank to a national association, which is regulated by the OCC. The OCC has minimum payment policies for the credit card industry designed to force modest positive amortization for all card accounts.

Under the new policy, the monthly minimum payment is set at 1% of principal balance, plus all interest assessed in the prior cycle, plus any past due fees and certain other fees assessed in the prior cycle. This compares to the Company s previous policy, which for most accounts was a flat 3% of principal balance. This will have the effect of increasing the minimum payment for delinquent customers, while lowering it for many customers who are current.

The Company has converted substantially all accounts to comply with OCC minimum payment policies as of year end.

Secondary Equity Offering

On September 30, 2008, the Company was able to take advantage of favorable market conditions and raised $760.8 million through the issuance of 15,527,000 shares of common stock at $49.00 per share.

Goodwill Impairment

During the fourth quarter of 2008 the Company recorded an impairment to goodwill of $810.9 million. The impairment was recorded in the Auto Finance sub-segment. See Section II Critical Accounting Estimates, *Valuation of Goodwill and Other Intangible Assets* for additional information.

Sale of MasterCard Shares

During the second quarter of 2008, the Company recognized a gain of $44.9 million in other non-interest income from the sale of 154,991 shares of MasterCard class B common stock.

Visa IPO

During the first quarter of 2008, Visa completed an initial public offering (IPO) of its stock. With IPO proceeds Visa established an escrow account for the benefit of member banks to fund certain litigation settlements and claims. As a result, in the first quarter of 2008, the Company reduced its Visa-related indemnification liabilities of $90.9 million recorded in other liabilities with a corresponding reduction of other non-interest expense. In addition, the Company recognized a gain of $109.0 million in non-interest income for the redemption of 2.5 million shares related to the Visa IPO. Both items were included in the Other segment.

Table of Contents

Debt Refinancing

During the first quarter of 2008, the Company repurchased approximately $1.0 billion of certain senior unsecured debt, recognizing a gain of $52.0 million in non-interest income. The Company initiated the repurchases to take advantage of the current market environment and replaced the repurchased debt with lower-rate unsecured funding.

Chevy Chase Bank Acquisition

On December 4, 2008, the Company announced its intention to acquire Chevy Chase Bank F.S.B., the largest retail depository institution in the Washington, D.C. region in a cash and stock transaction valued at approximately $520 million. On February 13, 2009, the Company received approval from the Federal Reserve to acquire all of the shares of Chevy Chase Bank F.S.B. and certain of its subsidiaries. The Company expects the transaction to close in the first quarter of 2009.

The Company expects the acquisition to be accretive to operating earnings per share in 2009 and accretive to GAAP earnings per share in 2010. The Company expects to incur approximately $225 million of merger and integration costs and achieve a reduction in non-interest costs of $125 million as a result of the acquisition. The Company anticipates taking a fair value mark of approximately $1.75 billion for expected losses on the Chevy Chase Bank loan portfolio.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Net income was $1.6 billion, or $3.97 per share (diluted) for 2007, compared to $2.4 billion, or $7.62 per share (diluted) for 2006. Net income for 2007 included an after-tax loss from discontinued operations of $1.0 billion, or $2.58 per share (diluted), compared to an after-tax loss from discontinued operations of $11.9 million, or $0.03 per share (diluted) in 2006.

Income from continuing operations for 2007 was $2.6 billion, an increase of $165.3 million, or 7% from 2006. Diluted earnings per share from continuing operations for 2007 was $6.55, a decrease of 14% from $7.65 in 2006.

Results from continuing operations for 2007 include:

- The impact of a full year of results of operations from the North Fork Bank acquisition which was completed on December 1, 2006 and the dilutive impact on earnings per share of the 103.8 million incremental shares issued in December 2006 related to the acquisition.

- Net interest income and non-interest income growth driven mainly by selective pricing and fee changes in the U.S. Card portfolio.

- Provision for loan and lease losses increase due to the continued normalization of consumer credit following the unusually favorable credit environment in 2006, adverse delinquency and charge-off trends in our National Lending businesses and the increase in our coverage ratio in allowance to loans held for investment as a result of economic weakening in the latter part of 2007, as evidenced by increased delinquencies and consistent with recently released economic indicators.

- Restructuring charges of $138.2 million resulting from the Company s broad-based initiative announced during the second quarter of 2007 to reduce expenses and improve its competitive cost position.

- Legal liabilities and reserves of $138.9 million in connection with the Visa antitrust lawsuit settlement with American Express and estimated possible damages in connection with other pending Visa litigation.

- The impact of the Company s $3.0 billion share repurchase program completed in 2007.

Moderate loan (held for investment) growth primarily attributable to the acquisition of North Fork in December 2006, offset somewhat by a portfolio sale related to a co-branded credit card partnership during first quarter 2007 and our significant pull back from prime revolver marketing in the U.S. Card sub-segment.

Moderate deposit decrease attributable to deliberate funding decisions including a shift from higher cost brokered deposits and public funds to lower cost funding options. Deposits were $83.0 billion at December 31, 2007, down $2.8 billion, or 3% from December 31, 2006.

2007 Summary of Significant Events

Shut Down of Mortgage Origination Operations of Wholesale Mortgage Banking Unit

Additional information can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 2.

Table of Contents

Restructuring Charges Associated with Cost Initiative

During the second quarter of 2007, we announced a broad-based initiative to reduce expenses and improve our competitive cost position. We recognized $138.2 million in restructuring charges in 2007. Additional information can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 14 .

Share Repurchase

During 2007, we executed a $3.0 billion stock repurchase program, resulting in a net share retirement of 43,717,110 shares. Additional information can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 10 .

Litigation Settlements and Reserves

During the fourth quarter of 2007, we recognized a pre-tax charge of $79.8 million for liabilities in connection with the antitrust lawsuit settlement with American Express. Additionally, we recorded a legal reserve of $59.1 million for estimated possible damages in connection with other pending Visa litigation, reflecting our share of such potential damages as a Visa member. Additional information can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 19 and Part 1, Item 3. *Legal Proceedings* .

Sale of Interest in Spain

During 2007, the Company completed the sale of its interest in a relationship agreement to develop and market consumer credit products in Spain and recorded a net gain related to this sale of $31.3 million consisting of a $41.6 million increase in non-interest income partially offset by a $10.3 million increase in non-interest expense.

Gain on Sale of MasterCard Shares

As a result of MasterCard s IPO in 2006, Capital One owned class B shares of MasterCard common stock, with sale restrictions that were originally scheduled to expire on May 31, 2010. In 2007 shareholders approved an amendment to the MasterCard Certificate of Incorporation that provides for an accelerated conversion of class B common stock into class A common stock. The MasterCard Board of Directors approved a conversion window running from August 4 to October 5, 2007, during which time owners of class B shares may voluntarily elect to convert and sell a certain number of their shares. During the conversion period, Capital One elected to convert and sell 300,482 shares of MasterCard class B common stock. The Company recognized gains of $43.4 million on these transactions in non-interest income.

Gain on Sale of Equity Interest in DealerTrack

In 2001 we acquired a 7% stake in the privately held company DealerTrack, a leading provider of on-demand software and data solutions for the automotive retail industry. DealerTrack went public in 2005. During the first quarter of 2007 we sold our remaining interest of 1,832,767 shares for $52.2 million resulting in a pre-tax gain of $46.2 million in non-interest income.

Senior Note Issuance

During the third quarter 2007, we closed the public offering of $1.5 billion aggregate principal amount of our Senior Notes Due 2017 (the Notes). The Notes were issued pursuant to a Senior Indenture dated as of November 1, 1996 (the Indenture) between the Corporation and The Bank of New York Trust Company, N.A. (as successor to Harris Trust and Savings Bank), as Indenture Trustee. Proceeds from the sale of the notes will be used for general corporate purposes, which may include repurchases of shares of our common stock. Additional information can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 8 and Part 2, Item 7, Section VIII. *Liquidity and Funding* .

Acceleration of Equity Awards

During the second quarter of 2007, a charge of $39.8 million was taken against salaries and associate benefits. This charge was taken as a result of the accelerated vesting of equity awards in conjunction with the transition of the Banking leadership team, consistent with the terms of the awards. This charge is not included as a restructuring charge associated with our 2007 cost initiative.

Income Taxes

We recognized a $69.0 million one-time tax benefit in the second quarter of 2007 resulting from previously unrecognized tax benefits related to our international tax position. In addition, we recognized a $29.7 million reduction in retained earnings associated with the adoption of FIN 48 in 2007.

Table of Contents

Business Outlook

The statements contained in this section are based on our current expectations regarding the Corporation s 2009 financial results and business strategies. Certain statements are forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those in our forward looking statements. Factors that could materially influence results are set forth throughout this section and in Item 1A Risk Factors .

2009 Expectations

The Company expects continued pressure on profitability as deteriorating global economic conditions continue to have an impact on credit performance and require the Company to increase its provision for loan losses.

Credit:

As of December 31, 2008, the Company s allowance is consistent with an outlook for $8.6 billion of managed losses in 2009. This loss outlook assumes that the U.S. unemployment rate increases to around 8.7% by the end of 2009, and that home prices, as measured by the Case-Schiller 20-City Index, decline by an additional 10 percentage points by the end of 2009.

The Company expects 2009 provision expense levels to be higher than 2008 provision expense levels.

In addition to the effects of the weakening economy, the Company expects that in 2009 the charge-off rate in the U.S. Card sub-segment will be adversely impacted by (i) continuing pressure from the unsecured closed-end loans included in the U.S. Card sub-segment; and (ii) from the implementation of the OCC minimum payment policies. The Company expects that the conversion to the OCC minimum payment policies will increase the U.S. Card charge-off rate by approximately 10 basis points in the first quarter of 2009, and by approximately 50 basis points in subsequent quarters of 2009. The Company expects that the impact of the new minimum payment policies on the Company s charge-off levels will begin to subside in 2010 as customers adjust to the new policies. The impact of the new policies has been factored into the Company s expectations for charge-off levels in the U.S. Card sub-segment, as discussed above, and in the Company s outlook for total company managed charge-off dollars for the next twelve months associated with the allowance for loan and lease losses.

The Company expects that the charge-off rate in the U.S. Card sub-segment will be around 8.1% in the first quarter of 2009.

Earning Assets: The Company expects that new loan originations, reduced by weakening demand from credit worthy borrowers, will not be sufficient to offset rising charge-offs, normal amortization and attrition, and weaker credit card spending. As a result, the Company expects a decline in managed loans. We expect that the decline in earning assets will be more modest, resulting in a continuing shift from loans to high-quality investment securities backed by mortgage and consumer loans.

Deposit Growth: The Company expects deposits in the Local Banking segment to grow in 2009. The Company also expects to continue to maintain disciplined pricing and deposit margins in 2009.

Revenue Margin: The Company expects a modest decline in 2009 revenue margin as compared to 2008 revenue margin, although there may be variability between quarterly periods.

Cost Management: The Company expects to continue to benefit from cost cutting actions taken in 2007 and 2008 and will pursue additional efforts to achieve sustainable efficiency through cost reductions, including realizing synergies from the Chevy Chase Bank acquisition.

Capital Management:

The Company s TCE (tangible common equity / tangible managed assets) ratio is currently impacted by unrealized losses associated with its investment portfolio. The Company does not anticipate that these unrealized losses would result in a materially permanent reduction in capital given the low risk of principal loss and that it is unlikely that the Company will need to liquidate securities prior to maturity for liquidity purposes as the Company has the intent and ability to hold the securities until recovery, which may be maturity.

The Company expects the TCE ratio to decline by about 100 basis points with the close of the Chevy Chase Bank F.S.B. acquisition.

The Company expects to maintain a strong TCE ratio in 2009. The TCE ratio is expected to remain below the long-term target range of 5.5% to 6.0% in 2009. The Company expects regulatory capital ratios to remain comfortably above the level required by regulators in 2009.

The Company will actively manage capital in conjunction with evolving views of the economy and portfolio trends. The Company believes it will maintain adequate capital ratios.

Table of Contents

VI. Financial Summary

Table 1 provides a summary view of the consolidated income statement and selected metrics at and for the years ended December 31, 2008, 2007 and 2006.

CAPITAL ONE FINANCIAL CORPORATION

Table 1: Financial Summary

	Year Ended December 31,			Change	
(Dollars in thousands)	**2008**	**2007[2]**	**2006[4][2]**	**2008 vs. 2007**	**2007 vs. 2006**
Earnings (Reported):					
Net Interest Income	**$ 7,148,715**	$ 6,529,845	$ 5,091,446	$ 618,870	$ 1,438,399
Non-Interest Income:					
Servicing and securitizations	**3,384,468**	4,840,677	4,209,637	(1,456,209)	631,040
Service charges and other customer-related fees	**2,232,363**	2,057,854	1,770,340	174,509	287,514
Mortgage servicing and other	**105,038**	166,776	177,893	(61,738)	(11,117)
Interchange	**562,117**	500,484	549,074	61,633	(48,590)
Other	**459,985**	488,432	294,080	(28,447)	194,352
Total non-interest income	**6,743,971**	8,054,223	7,001,024	(1,310,252)	1,053,199
Total Revenue[1]	**13,892,686**	14,584,068	12,092,470	(691,382)	2,491,598
Provision for loan and lease losses	**5,101,040**	2,636,502	1,476,438	2,464,538	1,160,064
Marketing	**1,118,208**	1,347,836	1,444,324	(229,628)	(96,488)
Restructuring expenses	**134,464**	138,237		(3,773)	138,237
Goodwill impairment charge[8]	**810,876**			810,876	138,237
Operating expenses	**6,146,479**	6,591,937	5,499,367	(445,458)	1,092,570
Income from continuing operations before taxes	**581,619**	3,869,556	3,672,341	(3,287,937)	197,215
Income taxes	**497,102**	1,277,837	1,245,964	(780,735)	31,873
Income from continuing operations, net of tax	**84,517**	2,591,719	2,426,377	(2,507,202)	165,342
Loss from discontinued operations, net of tax[5]	**(130,515)**	(1,021,387)	(11,884)	890,872	(1,009,503)
Net income (loss)	**$ (45,998)**	$ 1,570,332	$ 2,414,493	$ (1,616,330)	$ (844,161)
Net income (loss) available to common shareholders	**$ (78,721)**	$ 1,570,332	$ 2,414,493	$ (1,649,053)	$ (844,161)
Common Share Statistics:					
Basic earnings per common share:					
Income from continuing operations, net of tax	**$ 0.14**	$ 6.64	$ 7.84	$ (6.50)	$ (1.20)
Loss from discontinued operations, net of tax[5]	**(0.35)**	(2.62)	(0.04)	2.27	(2.58)
Net Income (loss) per common share	**$ (0.21)**	$ 4.02	$ 7.80	$ (4.23)	$ (3.78)
Diluted earnings per common share:					
Income from continuing operations, net of tax	**$ 0.14**	$ 6.55	$ 7.65	$ (6.41)	$ (1.10)
Loss from discontinued operations, net of tax[5]	**(0.35)**	(2.58)	(0.03)	2.23	(2.55)
Net Income (loss) per common share	**$ (0.21)**	$ 3.97	$ 7.62	$ (4.18)	$ (3.65)

Selected Balance Sheet Data[3]:					
Reported loans held for investment (period end)	**$ 101,017,771**	$ 101,805,027	$ 96,512,139	$ (787,256)	$ 5,292,888
Managed loans held for investment (period end)	**146,936,754**	151,362,417	146,151,268	(4,425,663)	5,211,149
Reported loans held for investment (average)	**98,970,902**	93,541,825	63,577,279	5,429,077	29,964,546
Managed loans held for investment (average)	**147,812,265**	144,727,006	111,328,595	3,085,259	33,398,411
Allowance for loan and lease losses	**4,523,960**	2,963,000	2,180,000	1,560,960	783,000
Interest bearing deposits (period end)	**97,326,937**	71,714,627	73,913,876	25,612,310	(2,199,249)
Total deposits (period end)	**108,620,789**	82,761,176	85,561,946	25,859,613	(2,800,770)
Interest bearing deposits (average)	**82,735,627**	73,764,911	45,592,382	8,970,716	28,172,529
Total deposits (average)	**$ 93,507,646**	$ 85,211,616	$ 50,526,789	$ 8,296,030	$ 34,684,827
Selected Company Metrics (Reported) [3]:					
Return on average assets (ROA)	**0.05%**	1.79%	2.55%	(1.74)	(0.76)
Return on average equity (ROE)	**0.33%**	10.28%	14.97%	(9.95)	(4.69)
Net charge-off rate	**3.51%**	2.10%	2.21%	1.41	(0.11)
Delinquency rate (30+ days)	**4.37%**	3.66%	2.74%	0.71	(0.92)
Net interest margin	**5.37%**	5.38%	6.06%	(0.01)	(0.68)
Revenue margin	**10.44%**	12.01%	14.38%	(1.57)	(2.37)
Risk adjusted margin [6]	**7.83%**	10.40%	12.71%	(2.57)	(2.31)
Selected Company Metrics (Managed) [3]:					
Return on average assets (ROA)	**0.04%**	1.33%	1.70%	(1.04)	(0.37)
Net charge-off rate	**4.35%**	2.88%	2.84%	1.47	0.04
Efficiency ratio [7]	**43.14%**	47.30%	50.17%	(4.16)	(2.87)
Delinquency rate (30+ days)	**4.49%**	3.87%	3.02%	0.62	0.85
Net interest margin	**6.37%**	6.46%	6.88%	(0.09)	(0.42)
Revenue margin	**9.39%**	9.85%	10.66%	(0.46)	(0.81)
Risk adjusted margin [6]	**5.81%**	7.40%	8.23%	(1.59)	(0.83)

(1) In accordance with the Company s finance charge and fee revenue recognition policy, the amounts billed to customers but not recognized as revenue were $1.9 billion, $1.1 billion and $0.9 billion for the years ended December 31, 2008, 2007 and 2006, respectively.

(2) Certain prior period amounts have been reclassified to conform to current period presentation.

(3) Based on continuing operations.

(4) On December 1, 2006, the Company acquired 100% of the outstanding common stock of North Fork Bancorporation for total consideration of $13.2 billion.
(5) Discontinued operations related to the shutdown of mortgage origination operations of GreenPoint s wholesale mortgage banking unit in 2007.
(6) Risk adjusted margin equals total revenue less net charge-offs as a percentage of average earning assets.
(7) Efficiency ratio equals non-interest expense less restructuring expense and goodwill impairment charge divided by total revenue.
(8) In the fourth quarter of 2008, the Company recorded impairment of goodwill in its Auto Finance sub-segment of $810.9 million.

Summary of the Reported Income Statement

The following is a detailed description of the financial results reflected in Table 1. Additional information is provided in Section XI, Tabular Summary as detailed in sections below.

The following discussion provides a summary of 2008 results compared to 2007 results and 2007 results compared to 2006 results on a continuing operations basis, unless otherwise noted. Each component is discussed in further detail in subsequent sections of this analysis.

Net interest income

Net interest income is comprised of interest income earned on securities and interest income and past-due fees earned and deemed collectible from the Company s loans, less interest expense on interest-bearing deposits, senior and subordinated notes, and other borrowings. For the year ended December 31, 2008, reported net interest income increased 9.5%, or $618.9 million.

Interest income on loans held for investment decreased modestly to $9.46 billion from $9.50 billion at the end of 2007 as the increase in average loans held for investment from $93.5 billion to $99.0 billion was offset by the impact of increasing delinquencies which caused our revenue suppression to increase to $1.9 billion from $1.1 billion in 2007, and by lower interest rates on our variable rate products as interest rates declined throughout the year.

Interest income on securities available for sale increased $273.0 million driven by increases in the average portfolio from $18.9 billion to $25.0 billion in 2008 while yields remained stable. The increase in the securities available for sale portfolio came as the Company continued to grow its deposit base and maintained our approach of holding high quality, low risk investments rather than taking excessive credit risk to generate incremental earnings. While interest rates declined throughout 2008, the Company maintained stable yields in growing the securities portfolio by taking advantage of market illiquidity to purchase securities at an attractive yield.

Interest expense on interest-bearing deposits decreased $394.3 million from 2007. The average balance on interest-bearing deposits increased to $82.7 billion from $74.0 billion while the yield decreased to 3.04% in 2008 from 3.94% as the Federal Reserve reduced the federal funds rate throughout 2008.

For the year ended December 31, 2007, reported net interest income increased 28%, or $1.4 billion, compared to 2006. The increase was driven by the acquisition of North Fork, modest loan growth and increased margins in the U.S Card sub-segment due to selective pricing changes implemented after the completion of our card holder system conversion in 2007. Net interest margin decreased 68 basis points for the year ended December 31, 2007, primarily due to the addition of the lower net interest margin North Fork business.

For additional information, see section XI, Tabular Summary, Table A and Table B.

Non-interest income

Non-interest income is comprised of servicing and securitizations income, mortgage servicing and other, service charges and other customer-related fees, interchange income and other non-interest income.

For the year ended December 31, 2008, non-interest income decreased 16%. For the year ended December 31, 2007, non-interest income increased 15%. See detailed discussion of the components of non-interest income below.

Servicing and Securitizations Income

Servicing and securitizations income represents servicing fees, excess spread and other fees derived from the off-balance sheet loan portfolio, adjustments to the fair value of retained interests derived through securitization transactions, as well as gains and losses resulting from securitization and other sales transactions.

Servicing and securitizations income decreased 30% for the year ended December 31, 2008. The decrease was attributable to reductions in average securitized loans year over year and to reductions in fair value of the interest-only strips of $224.8 million due to the worsening global credit environment. Average securitized loans were $48.8 billion for 2008 compared to $51.2 billion for 2007.

Servicing and securitizations income increased 15% for the year ended December 31, 2007. This increase was attributable to higher net gains on sales resulting from higher revenue generated from selective pricing and fee changes in the U.S. card

Table of Contents

portfolio offset somewhat by higher charge-offs in the securitized portfolio resulting from continued normalization of credit losses and a 7% increase in average securitized loans year over year. Average securitized loans were $51.2 billion for 2007 compared to $47.8 billion in 2006.

Service Charges and Other Customer-Related Fees

For 2008, service charges and other customer-related fees grew 8% due to higher overlimit and cash advance fees.

For 2007, service charges and other customer-related fees grew 16% due to the inclusion of North Fork and selective pricing changes in the U.S. Card sub-segment.

Mortgage Servicing and Other Income

Mortgage servicing and other income is comprised of non-interest income related to our mortgage servicing business and other mortgage related income. For the year ended December 31, 2008, mortgage servicing and other income decreased 37% from the prior year due to the changes in fair value of the mortgage servicing rights attributable to the run-off of the portfolio and reduced gains on sales due to lower originations in 2008.

For the year ended December 31, 2007, mortgage servicing and other income decreased 6% from prior year due to the changes in fair value of the mortgage servicing rights attributable to the run-off of the portfolio and lack of originations subsequent to the shutdown of GreenPoint s mortgage origination business in 2007.

Interchange

Interchange income, net of rewards expense, increased 12.3% for the year ended December 31, 2008 on a reported basis due to a shift in loans from a reduction in our off-balance sheet securitized loans to an increase in our reported on-balance sheet loans during 2008. Interchange on a managed basis decreased 7.8% due to decreases in managed purchase volume of 1.2% and increases in rewards expense. Costs associated with the Company s rewards programs in 2008 were $221.4 million on a reported basis and $709.2 million on a managed basis. The increase in the rewards expense was due to an expansion of our rewards programs.

Interchange income, net of rewards expense, decreased 9% for the year ended December 31, 2007 due to decreases in reported purchase volume of 3% and higher costs associated with our rewards programs of 3%. Managed U.S. Card purchase volume increased 3% compared to 2006. Costs associated with the Company s rewards programs in 2007 were $182.9 million on a reported basis and $602.2 million on a managed basis.

Other Non-Interest Income

Other non-interest income includes, among other items, gains and losses on sales of securities, gains and losses associated with hedging transactions and revenue generated by our healthcare finance business.

Other non-interest income for the year ended December 31, 2008 decreased $28.4 million or 5.8%. The decrease was primarily due to reduced commission income and changes in exchange rates from 2007. Other non-interest income for 2008 also includes a $109.0 million gain from the redemption of shares related to the Visa IPO and a gain of $44.9 million from the sale of MasterCard stock.

Other non-interest income for the year ended December 31, 2007 increased $194.4 million or 66%. The increase is primarily due to the North Fork acquisition. Other non-interest income for 2007 also includes a $46.2 million gain from the sale of a stake in DealerTrack Holding Inc., a $41.6 million gain on sale of our interest in a relationship agreement to develop and market consumer credit products in Spain and gains from sales of MasterCard stock of $43.4 million.

Provision for loan and lease losses

Provision for loan and lease losses increased $2.5 billion, or 93% for the year ended December 31, 2008. The increase in the provision is a result of continued worsening of the economy which rapidly deteriorated during the later part of 2008 as evidenced by increases in both the charge-off rate and delinquency rate, rising to 3.51% and 4.37%, respectively, from 2.10% and 3.66%, respectively. The provision for loan and lease loses increased $1.0 billion in the fourth quarter alone as the Company increased the allowance for loan and lease losses as the unemployment rate and housing prices showed significant worsening during the fourth quarter of 2008.

Provision for loan and lease losses increased $1.2 billion, or 79% for the year ended December 31, 2007. The increase in provision is a result of the continued normalization of consumer credit following the unusually favorable credit environment in 2006, adverse charge-off and delinquency trends in our National Lending businesses and the increase in our coverage ratio of allowance to loans held for investment as a result of economic weakening in the latter part of 2007 as evidenced by increased delinquency rates and consistent with recently released economic indicators.

Table of Contents

Non-interest expense

Non-interest expense consists of marketing, goodwill impairment and operating expenses.

For the year ended December 31, 2008, non-interest expense, excluding goodwill impairment, decreased 8%. For the year ended December 31, 2007, non-interest expense increased 16%. See detailed discussion of the components of non-interest expense below.

Marketing

Marketing expenses decreased 17% for the year ended December 31, 2008. The decrease in marketing expenses was due to selective pull-backs in certain marketing channels and other reductions in response to the changes in the economic environment.

Marketing expenses decreased 7% for the year ended December 31, 2007. The decrease in marketing expenses was due to selective pull-backs in certain marketing channels.

Goodwill impairment

The Company recorded an impairment to goodwill of $810.9 million, as a result of a reduced estimate of the fair value of the Auto Finance sub-segment due to business decisions to scale back origination volume in that business. For additional information, see Section II Critical Accounting Estimates, Valuation of Goodwill and Other Intangible Assets .

Operating Expenses

Operating expenses decreased 7% for the year ended December 31. 2008. The decrease in operating expenses was a direct result of benefits from the Company s continued cost reduction initiatives.

Operating expenses increased 22% for the year ended December 31. 2007. The increase The increase in operating expense was driven by the addition of North Fork s operating expenses, CDI amortization and integration expenses associated with our bank acquisitions, litigation accruals related to industry litigation, restructuring charges associated with our cost initiative, and the accelerated vesting of restricted stock related to the transition to new management in our Local Banking segment.

Income Taxes

The Company s effective tax rate was 85.5%, 33.0% and 33.9% for the years ended December 31, 2008, 2007 and 2006, respectively. The effective rate includes federal, state, and international tax components. The increase in the 2008 rate compared to the 2007 rate was primarily due to the non-deductible portion of the goodwill impairment recognized during 2008. The Company s effective tax rate excluding the goodwill impairment was 37.8%. The decrease in the 2007 rate compared to the 2006 rate was primarily due to changes in the Company s international tax position recognized in the second quarter 2007 in the amount of $69.0 million and increases in certain tax credits.

Loan Portfolio Summary

The Company analyzes its financial performance on a managed loan portfolio basis. The managed loan portfolio is comprised of on-balance sheet and off-balance sheet loans. The Company has retained servicing rights for its securitized loans and receives servicing fees in addition to the excess spread generated from the off-balance sheet loan portfolio.

Average managed loans held for investment from continuing operations grew $3.1 billion, or 2%, for the year ended December 31, 2008. The modest growth in 2008 was a result of increases in Local Banking and U.S. Card which was mostly offset by reductions in our International and Auto Finance sub-segments.

Average managed loans held for investment from continuing operations grew $33.4 billion, or 30%, for the year ended December 31, 2007. The increase in average managed loans held for investment during 2007 was due to the North Fork acquisition in late 2006.

For additional information, see section XI, Tabular Summary, Table C and Table D.

Asset Quality

Delinquencies

The Company believes delinquencies to be an indicator of loan portfolio credit quality at a point in time.

The 30-plus day delinquency rate for the reported and managed loan portfolio increased 71 and 62 basis points to 4.37% and 4.49%, respectively, from December 31, 2007 to December 31, 2008. The increase was due to the continued worsening of the economy which rapidly deteriorated during the second half of 2008 impacting both the National Lending and Local Banking segments.

The 30-plus day delinquency rate for the reported and managed loan portfolio increased 92 and 85 basis points to 3.66% and 3.87%, respectively, from December 31, 2006 to December 31, 2007. The acquisition of the lower loss North Fork loan portfolio reduced reported and managed delinquency rates. The decrease was offset by normalization of credit following the unusually favorable credit environment in 2006, selective pricing and fee policy moves in the U.S. Card sub-segment, the significant pull back from prime revolver marketing in the U.S. Card sub-segment, continued elevated losses in the Auto Finance sub-segment, and from economic weakening evidenced by increased delinquencies and consistent with recently released economic indicators.

For additional information, see section XI, Tabular Summary, Table E.

Net Charge-Offs

Net charge-offs include the principal amount of losses (excluding accrued and unpaid finance charges and fees and fraud losses) less current period principal recoveries. We charge-off credit card loans at 180 days past the statement cycle date and generally charge-off other consumer loans at 120 days past the due date or upon repossession of collateral. Bankruptcies charge-off within 30 days of notification and deceased accounts charge-off within 60 days of notification. Commercial loans are charged-off when the amounts are deemed uncollectible. Costs to recover previously charged-off accounts are recorded as collection expenses in other non-interest expense.

For 2008, reported and managed net charge-off rates increased 141 basis points and 147 basis points to 3.51% and 4.35%, respectively. The increase in both the reported and managed charge-off rates was due to the continued worsening of the economy which rapidly deteriorated during the second half of 2008. The reported charge-off dollars totaled $3.5 billion during 2008, an increase of 77% from 2007. The managed charge-off dollars totaled $6.4 billion, increasing 54% from 2007.

For 2007 reported and managed net charge-off rates decreased 11 basis points to 2.10% and increased 4 basis points to 2.88%, respectively. The decrease in the reported charge-off rate was impacted by the higher credit quality North Fork loan portfolio for a full year 2007 which more than offset the effects of continued consumer credit normalization and economic weakness during the latter part of 2007. The impacts of the continued credit normalization and economic weakness also had a significant impact on the managed charge-off rate for the Company s credit card securitization programs. Year-to-date reported and managed net charge-off dollars increased 39% and 32%, respectively, compared to the prior year.

For additional information, see section XI, Tabular Summary, Table F.

Nonperforming Loans

Nonperforming loans as a percentage of total loans held for investment were 0.80% and 0.39% at December 31, 2008 and 2007, respectively. The increase in nonperforming loans was due to the continued economic weakening and credit deterioration during 2008.

For additional information, see section XI, Tabular Summary, Table G.

Allowance for loan and lease losses

The allowance for loan and lease losses related to loans held for investment increased $1.5 billion, or 53% to $4.5 billion at December 31, 2008. The increase is due to the continued worsening of the economy which rapidly deteriorated during the second half of 2008 increasing our expectation of credit losses in 2009. Certain factors impacting the calculation of the allowance for loan and lease losses, such as the unemployment rate and housing prices, showed significant worsening during the fourth quarter of 2008 contributing to a $1.0 billion increase in the allowance for loan and lease losses during the fourth quarter alone.

The allowance for loan and lease losses related to loans held for investment increased $783.0 million, or 36% to $3.0 billion at December 31, 2007. The increase is driven primarily by an increase in our coverage ratio of allowance to loans held for investment as a result of economic weakening in the latter part of 2007 as evidenced by increased delinquencies and consistent with recently released economic indicators.

For additional information, see section XI, Tabular Summary, Table H.

Table of Contents

VII. Reportable Segment Summary for Continuing Operations

We manage our business as two distinct operating segments: Local Banking and National Lending. The Local Banking and National Lending segments are considered reportable segments based on quantitative thresholds applied to the managed loan portfolio for reportable segments provided by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information.*

As management makes decisions on a managed basis within each segment, information about reportable segments is provided on a managed basis.

In 2007, the Company shut down mortgage origination operations of its wholesale mortgage banking unit, GreenPoint. The results of the mortgage origination operations are being reported as discontinued operations for each period presented, and are not included in segment results of the Company. The results of GreenPoint s mortgage servicing business continue to be reported as part of the Company s continuing operations. The mortgage servicing function was moved into the Local Banking segment in conjunction with the shutdown of the mortgage origination operation, and the results of the Local Banking segment were restated to include the mortgage servicing results for each period of 2007. During 2007, GreenPoint s held for investment commercial mortgage portfolio results were moved into the Local Banking segment. GreenPoint s held for investment consumer portfolio results were moved into the Other segment in 2007.

We maintain our books and records on a legal entity basis for the preparation of financial statements in conformity with GAAP. The following table presents information prepared from our internal management information system, which is maintained on a line of business level through allocations from legal entities.

Table of Contents

Local Banking Segment

Table 2: Local Banking

(Dollars in thousands)	As of and for the Year ended December 31 2008	2007	2006
Earnings (Managed Basis)			
Interest income	**$ 6,096,293**	$ 6,937,321	$ 2,792,024
Interest expense	**3,673,482**	4,601,269	1,785,044
Net interest income	**2,422,811**	2,336,052	1,006,980
Non-interest income	**813,742**	939,638	595,096
Total revenue	**3,236,553**	3,275,690	1,602,076
Provision for loan and lease losses	**447,643**	32,178	602
Non-interest expense	**2,443,369**	2,333,955	1,269,868
Income before taxes	**345,541**	909,557	331,606
Income taxes	**120,939**	316,464	116,062
Net income	**$ 224,602**	$ 593,093	$ 215,544
Selected Metrics (Managed Basis)			
Commercial lending			
Commercial and multi-family real estate (4)	**13,382,909**	12,414,263	891,140
Middle market (5)	**10,081,823**	8,288,476	3,524,564
Small ticket commercial real estate (6)	**2,609,123**	2,948,402	
Specialty lending (7)	**3,547,287**	3,396,100	
Total commercial lending	**29,621,142**	27,047,241	4,415,704
Small business lending (8)	**4,747,783**	4,612,500	3,640,787
Consumer lending			
Mortgages (9)	**7,187,805**	8,513,216	444,108
Branch based home equity & other consumer (10)	**3,773,397**	4,095,228	3,816,185
Total consumer lending	**10,961,202**	12,608,444	4,260,293
Other (11)	**(247,146)**	(295,390)	(171,251)
Period end loans held for investment	**$ 45,082,981**	$ 43,972,795	$ 12,145,533
Average loans held for investment	**$ 44,318,212**	$ 42,272,403	$ 13,225,559
Core deposits (1)	**$ 67,546,102**	$ 62,977,637	$ 27,071,324
Total deposits	**$ 78,938,391**	$ 73,089,284	$ 35,187,965
Loans held for investment yield	**6.42%**	7.04%	7.75%
Net interest margin loans (2)	**2.00%**	1.86%	3.24%
Net interest margin deposits (3)	**2.07%**	2.03%	1.56%
Efficiency ratio	**75.49%**	71.25%	79.26%
Charge-off rates			
Commercial lending			
Commercial and multi-family real estate	**0.36%**	0.02%	0.00%
Middle market	**0.21%**	0.04%	0.14%
Small ticket commercial real estate	**0.31%**	0.18%	0.00%

Specialty lending	**0.24%**	0.11%	0.00%
Total commercial lending	**0.29%**	0.05%	0.11%
Small business lending	**1.04%**	0.47%	0.44%
Consumer lending			
Mortgages	**0.35%**	0.11%	0.07%
Branch based home equity & other consumer	**1.14%**	0.75%	0.53%
Total consumer lending	**0.62%**	0.31%	0.37%
Net charge-off rate	**0.50%**	0.21%	0.43%
Non performing loans	**$ 565,791**	$ 178,385	$ 57,824
Foreclosed assets	**63,970**	14,058	11,838
Non performing assets	**$ 629,761**	$ 192,443	$ 69,662

50

Table of Contents

(Dollars in thousands)	As of and for the Year ended December 31 2008	2007	2006
Non performing loans as a % of loans held for investment	**1.25%**	0.40%	0.48%
Non performing asset rates [12]			
Commercial lending			
Commercial and multi-family real estate	**1.20%**	0.24%	1.52%
Middle market	**0.43%**	0.41%	0.33%
Small ticket commercial real estate	**6.67%**	0.54%	0.00%
Specialty lending	**1.05%**	0.18%	0.00%
Total commercial lending	**1.40%**	0.32%	0.57%
Small business lending	**1.79%**	1.06%	0.90%
Consumer lending			
Mortgages	**1.55%**	0.54%	0.90%
Branch based home equity & other consumer	**0.46%**	0.30%	0.21%
Total consumer lending	**1.18%**	0.46%	0.28%
Total non performing asset rate	**1.39%**	0.44%	0.57%
Non-interest expense as a % of average loans held for investment	**5.51%**	5.52%	10.46%
Number of active ATMs	**1,311**	1,288	661
Number of locations	**739**	742	358

(1) Core deposits includes domestic non-interest bearing deposits, NOW accounts, money market deposit accounts, savings accounts, certificates of deposit of less than $100,000 and other consumer time deposits.
(2) Net interest margin loans equals net interest income loans divided by average managed loans.
(3) Net interest margin deposits equals net interest deposits divided by average retail deposits.
(4) Commercial and multi-family real estate targets private developers and commercial property investors and owners with credit requirements up to $100 million.
(5) Middle market focuses on businesses with annual revenues between $10 million and $250 million located within the segment s local footprint.
(6) Small ticket commercial real estate is comprised of small business products, mainly mixed-use and multi-family real-estate in the Local Banking segment.
(7) Specialty lending provides equipment leasing and other specialized lending in the national marketplace.
(8) Small business lending is focused on businesses with $10 million or less in revenues and $3 million or less in household size.
(9) Mortgage lending includes held for investment first lien residential mortgage assets.
(10) Branch based home equity and other consumer lending primarily includes home equity loans and lines of credit in the local consumer banking segment, and some consumer unsecured loans and lines of credit.
(11) Other loans held for investment includes unamortized premiums and discounts recognized on loans acquired in North Fork and Hibernia acquisitions, certain items in process, and other loans originated by the Local Banking segment.
(12) Non performing assets is comprised of non performing loans and foreclosed assets. The non performing asset rate equals non performing assets divided by the sum of loans held for investment plus foreclosed assets.

The Local Banking segment includes the Company s branch, treasury services and national deposit gathering activities; its commercial, branch based small business and certain branch originated consumer lending; and its mortgage servicing.

Beginning in 2006, we added a Local Banking segment. The Local Banking segment represents the results of the legacy Hibernia and North Fork business lines, except for the indirect auto business and the investment portfolio results. The legacy indirect auto businesses of both Hibernia and North Fork are included in the Auto Finance sub-segment results, and the respective investment portfolio results are included in the Other segment. The impacts of the North Fork acquisition for the year ended December 31, 2006 are included in the Other segment.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

The Local Banking segment contributed $224.6 million of net income during 2008, compared to $593.1 million during 2007. At December 31, 2008, loans outstanding in the Local Banking segment totaled $45.1 billion while deposit balances totaled $78.9 billion compared to loans outstanding of $44.0 billion and deposits of $73.1 billion at December 31, 2007. The increase in loans can be attributed to 9.5% growth in commercial loans, primarily in our middle market portfolio as the Gulf South region, with a concentration in the energy sector, weathered the economic downturn better than other markets, partially offset by runoff in our residential mortgage portfolio. Deposits grew 8%, primarily driven by increases in our national direct and our consumer branch deposits.

Local Banking segment profits are primarily generated from net interest income, which represents the yield earned on the loans less the internal transfer price charged to the business for those loans, plus the spread between deposit interest costs and the funds transfer price credited to the business for those deposits. During 2008, the Local Banking segment generated net interest income of $2.4 billion compared to $2.3 billion during 2007. The increase in net interest income can be attributed to higher net interest margin on both loans and deposits.

Table of Contents

Non-interest income declined from $939.9 million in 2007 to $813.7 million in 2008. Compared to 2007, mortgage originations decreased significantly due to the continued industry-wide challenges in the mortgage market. Lower gain on sale revenue and an increase in representation and warranty reserves resulted in a year over year decline of $102.7 million in non-interest income. In addition, revenue in the mortgage servicing business declined $19.0 million in 2008 from 2007 as the principal balance of loans serviced continued to decline year over year.

Provision for loan and lease losses was $447.6 million in 2008 compared to $32.2 million in 2007, as charge-offs increased to $222.4 million and an increase to the allowance for loan and lease losses. The increase in provision expense was related to the deterioration in the economy during 2008. Deteriorating economic conditions negatively impacted borrowers ability to repay and decreased collateral values, resulting in an increase in criticized and non-performing loans and charge-offs during the year.

Non-interest expenses were $2.4 billion in 2008, compared to $2.3 billion in 2007. In addition to investments in branches and other infrastructure projects, during 2008 the Local Banking segment continued to incur North Fork Bank integration costs such as brand conversion and deposit system integration. In 2008, the Company opened 21 new banking locations across Louisiana, New Jersey, New York, Texas and Virginia while closing 24 branches. The costs of operating these branches, including lease costs, depreciation and personnel, is included in non-interest expense.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

The Local Banking segment contributed $574.2 million of net income during 2007, compared to $178.6 million during 2006. At December 31, 2007, loans outstanding in the Local Banking segment totaled $44.0 billion while deposits outstanding totaled $73.3 billion. The increases in loans and deposits outstanding are due primarily to the addition of the loan and deposit portfolios of North Fork Bank, along with modest growth in loans and deposits during 2007. As of December 31, 2006, North Fork loan and deposit balances of $30.1 billion and $37.8 billion, respectively, were included in the Other segment.

Local Banking segment profits are primarily generated from net interest income, which represents the spread between loan yields and the internal cost of funds charged to the business for those loans, plus the spread between deposit interest costs and the funds transfer price credited to the business for those deposits. During 2007, the Local Banking segment generated net interest income of $2.3 billion compared to $996.9 million during 2006. The increase is due to the increase in loan and deposit outstandings mentioned above. The net interest margin on loans was lower in 2007 than 2006 because of the addition of the North Fork loan portfolio, which contained a higher percentage of lower yielding loans than the Hibernia portfolio. Net interest margins on deposits are higher in 2007 than in 2006 because of the addition of the lower cost North Fork deposit portfolio to the existing Hibernia and Capital One deposits.

The provision for loan losses increased to $32.1 million in 2007 from $0.4 million in 2006. The increase is primarily the result of the addition of the North Fork loan portfolios in 2007, offset by a $91.4 million reduction in the allowance for loan losses to conform the allowance for loan and lease losses methodology of the Local Banking segment to the Company s established methodology. In addition, during 2006, $25.7 million of allowance for loan losses previously established to cover expected losses in the portion of the loan portfolio impacted by Hurricanes Katrina and Rita was no longer needed and these amounts reduced the overall provision expense in 2006.

Non-interest expenses were $2.3 billion in 2007, compared to $1.2 billion in 2006. The primary reason for the increase is the addition of North Fork to the Local Banking segment results in 2007. In addition, during 2007 the Local Banking segment continued to incur costs associated with the integration of Hibernia and North Fork. These activities progressed as planned during the year and all Hibernia related integration activities were completed. In 2007, the Company opened 39 new banking locations across Louisiana, New Jersey, New York, Texas and Virginia. The costs of operating these branches, including lease costs, depreciation and personnel, is included in non-interest expense.

National Lending Segment

Table 3: National Lending

	As of and for the Year Ended December 31,		
(Dollars in thousands)	**2008**	**2007**	**2006**
Earnings (Managed Basis)			
Interest income	**$ 13,068,005**	$ 13,675,686	$ 12,070,528

Interest expense	**4,077,131**	4,834,450	4,174,394
Net interest income	**8,990,874**	8,841,236	7,896,134
Non-interest income	**4,737,612**	4,870,727	4,375,126
Total revenue	**13,728,486**	13,711,963	12,271,260
Provision for loan and lease losses	**7,428,476**	4,691,687	3,207,646

Table of Contents

(Dollars in thousands)	As of and for the Year Ended December 31, 2008	2007	2006
Goodwill impairment	**810,876**		
Non-interest expense	**4,893,898**	5,420,204	5,529,104
Income before taxes	**595,236**	3,600,072	3,534,510
Income taxes	**485,265**	1,237,163	1,240,608
Net income	**$ 109,971**	$ 2,362,909	$ 2,293,902
Selected Metrics (Managed Basis)			
Period end loans held for investment	**$ 101,147,134**	$ 106,508,443	$ 102,359,180
Average loans held for investment	**$ 102,689,253**	$ 102,235,384	$ 95,396,391
Total deposits	**$ 1,459,131**	$ 2,050,861	$ 2,383,902
Loans held for investment yield	**12.73%**	13.38%	12.65%
Net interest margin	**8.76%**	8.65%	8.28%
Revenue margin	**13.37%**	13.41%	12.86%
Risk adjusted margin	**7.49%**	9.45%	9.62%
Non-interest expense as a % of average loans held for investment	**4.77%**	5.30%	5.80%
Efficiency ratio	**35.65%**	39.53%	45.06%
Net charge-off rate	**5.88%**	3.96%	3.24%
30+ day delinquency rate	**5.93%**	5.17%	4.09%
Number of accounts (000s)	**44,816**	48,537	49,373

The National Lending segment consists of two sub-segments: U.S. Card and Other National Lending. Other National Lending consists of Auto Finance and International.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

The National Lending segment contributed $110.0 million of net income during 2008, compared to $2.4 billion during 2007. At December 31, 2008, loans outstanding in the National Lending segment totaled $101.1 billion while deposits outstanding totaled $1.5 billion. Profits are primarily generated from net interest income, which includes past-due fees earned and deemed collectible from our loans, and non-interest income, which includes fee-based services to customers. The reduction in net income was driven by an increase in the provision for loan and lease losses of $2.7 billion to $7.4 billion and by the recognition of an impairment on goodwill of $810.9 million in the Auto Finance sub-segment partially offset by a $526.3 million decrease in non-interest expense due to benefits from the Company s cost reduction initiatives. The increase in the provision for loan and lease losses was due to a significantly worse credit environment in 2008 as evidenced by an increase in the net charge-off rate to 5.88% from 3.96% in 2007. Total revenue was flat compared to 2007 as average managed loans held for investment were essentially level, increasing only 0.44% from 2007 levels, with growth in U.S. Card offset by declines in both Auto Finance and International. The net interest margin and revenue margin were 8.76% and 13.37%, respectively, during 2008 compared to 8.65% and 13.41%, respectively, during 2007. The risk adjusted margin decreased to 7.49% from 9.45% in 2007 due to the increase in charge-offs. Accounts have declined by 3.7 million in U.S. Card as the Company closed approximately 2 million inactive accounts during the second quarter of 2008. See below for a detailed discussion of the results of the U.S. Card, Auto Finance and International sub-segments.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

The National Lending segment contributed $2.4 billion of net income during 2007, compared to $2.3 billion during 2006. At December 31 2007, loans outstanding in the National Lending segment totaled $106.5 billion while deposits outstanding totaled $2.1 billion. Profits are primarily generated from net interest income, which includes past-due fees earned and deemed collectible from our loans, and non-interest income, which includes fee-based services to customers. Total revenue increased 12% during 2007 primarily due to growth in the average managed loans held for investment portfolio of 7% and selective pricing and fee changes following conversion of our cardholder system. Provision for loan and lease losses increased $1.5 billion, or 46%, during 2007, compared to 2006 due to normalization of credit following the unusually favorable credit environment in 2006, selective pricing and fee policy moves in the U.S. Card sub-segment, the significant pull back from prime revolver marketing in the U.S. Card sub-segment, continued elevated losses in the Auto Finance sub-segment, and from economic weakening consistent with recently released economic indicators.

53

Table of Contents

U.S. Card Sub-Segment

Table 4: U.S. Card

(Dollars in thousands)	As of and for the Year Ended December 31, 2008	2007	2006
Earnings (Managed Basis)			
Interest income	**$ 8,986,301**	$ 9,407,355	$ 8,313,110
Interest expense	**2,494,215**	3,135,436	2,773,610
Net interest income	**6,492,086**	6,271,919	5,539,500
Non-interest income	**4,127,615**	4,136,158	3,700,765
Total revenue	**10,619,701**	10,408,077	9,240,265
Provision for loan and lease losses	**5,460,986**	3,033,217	2,016,476
Non-interest expense	**3,618,639**	3,934,574	4,100,966
Income before taxes	**1,540,076**	3,440,286	3,122,823
Income taxes	**539,026**	1,183,458	1,093,289
Net income	**$ 1,001,050**	$ 2,256,828	$ 2,029,534
Selected Metrics (Managed Basis)			
Period end loans held for investment	**$ 70,944,581**	$ 69,723,169	$ 68,856,534
Average loans held for investment	**$ 68,634,756**	$ 66,774,914	$ 63,774,470
Loans held for investment yield	**13.09%**	14.09%	13.04%
Net interest margin	**9.46%**	9.39%	8.69%
Revenue margin	**15.47%**	15.59%	14.49%
Risk adjusted margin	**9.14%**	11.59%	11.37%
Non-interest expense as a % of average loans held for investment	**5.27%**	5.89%	6.43%
Efficiency ratio	**34.07%**	37.80%	44.38%
Net charge-off rate	**6.33%**	4.00%	3.12%
30+ day delinquency rate	**4.78%**	4.28%	3.30%
Purchase Volume[1]	**$ 103,035,146**	$ 105,875,472	$ 102,079,717
Number of total accounts (000s)	**37,436**	41,044	42,174

(1) Includes purchase transactions net of returns and excludes cash advance transactions.

The U.S. Card sub-segment consists of domestic consumer credit card lending, national small business lending, installment loans and other unsecured consumer financial service activities.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Period end loans outstanding increased $1.2 billion, or 2%, with modest growth in our credit card business being partially offset by pullbacks in closed-end loans. Purchase volume decreased by 3% year over year, particularly in the fourth quarter, as purchases did not show seasonal growth, actually declining from the third quarter. Lower payments have offset the decreased purchase volume, with a decline of 4% from 2007 to 2008. Accounts have declined by 3.7 million primarily in the U.S. Card sub-segment as the Company closed approximately 2 million inactive accounts during the second quarter of 2008.

The U.S. Card sub-segment had earnings of $1.0 billion in 2008, a decline of 56% year over year, driven by higher losses and allowance builds on worsening credit, partially offset by slightly increased revenue and lower non-interest expenses. The slight increase in revenue was due to lower interest expenses, while the decrease in non-interest expense was due to benefits from the Company s cost reduction initiatives.

Total revenues increased by 2% over the prior year, with slight increases in both interest and non-interest income. Net interest margin increased 7 basis points to 9.46%, which combined with increases in loans held for investment accounted for the bulk of the higher revenues.

The provision for loan and lease losses increased 80% to $5.5 billion during 2008, driven entirely by a significantly worse credit environment. Net adjusted charge-offs increased $1.7 billion, or 63%, during the year to $4.3 billion. The allowance for loan and lease losses increased $751.1 million, or 207%. The net charge-off rate increased 233 basis points over 2007 for a full-year rate of 6.33%, while the 30+ day delinquency rate increased 50 basis points to end the year at 4.78%.

Total non-interest expenses decreased 8% from 2007 to $3.6 billion. Marketing expenses declined as a result of risk-related pullbacks and improved marketing efficiency. Operating expenses declined as a result of continued focus on efficiency gains.

Table of Contents

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

The U.S. Card sub-segment had earnings of $2.3 billion, an increase of 11% year-over-year due to higher revenue generation and increased operational efficiency, partially offset by the worsening credit environment and associated allowance build.

Period end loans outstanding increased $1.0 billion, or 1%, during 2007, mainly due to heavy growth within installment loans and small business products, partially offset by a portfolio sale related to the exit of a co-branded consumer card partnership at the end of the first quarter of 2007. Purchase volume increased $3.8 billion, or 4%, with increases in both consumer card, 3%, and small business, 7%.

Total revenues increased by $1.2 billion, or 13%, over the prior year, as margins expanded due to product and marketing strategy changes implemented in 2007. Net interest margin increased 70 bps to 9.39%, while revenue margin increased 110 bps to 15.59%, primarily due to selective pricing and fee changes within consumer card.

The provision for loan and lease losses increased 50% to $3.0 billion during 2007. The increase is partly driven by the normalization of credit in 2007 following the unusually favorable credit environment in 2006, in addition to general economic weakening. Net adjusted charge-offs increased $681 million, or 34%, and the allowance for loan and lease losses increased $334 million as all businesses experienced worsenings.

Non-interest expenses for 2007 decreased $166 million, or 4%, due to lower marketing spend as a result of evolving marketing strategy, and slightly lower operating expenses from increased operational efficiency.

Other National Lending Sub-Segment

Table 5: Other National Lending

	As of and for the Year Ended December 31,		
(Dollars in thousands)	**2008**	**2007**	**2006**
Earnings (Managed Basis)			
Interest income	**$ 4,081,704**	$ 4,268,331	$ 3,757,418
Interest expense	**1,582,916**	1,699,014	1,400,784
Net interest income	**2,498,788**	2,569,317	2,356,634
Non-interest income	**609,997**	734,569	674,361
Total revenue	**3,108,785**	3,303,886	3,030,995
Provision for loan and lease losses	**1,967,490**	1,658,470	1,191,170
Goodwill impairment charge	**810,876**		
Non-interest expense	**1,275,259**	1,485,630	1,428,138
Income (loss) before taxes	**(944,840)**	159,786	411,687
Income taxes	**(53,761)**	53,705	147,319
Net income	**$ (891,079)**	$ 106,081	$ 264,368
Selected Metrics (Managed Basis)			
Period end loans held for investment	**$ 30,202,553**	$ 36,785,274	$ 33,502,646
Average loans held for investment	**$ 34,054,497**	$ 35,460,470	$ 31,695,965
Loans held for investment yield	**11.99%**	12.04%	11.85%
Net interest margin	**7.34%**	7.25%	7.44%
Revenue margin	**9.13%**	9.32%	9.56%
Risk adjusted margin	**4.17%**	5.44%	6.08%
Non-interest expense as a % of average loans held for investment	**3.74%**	4.19%	4.51%
Efficiency ratio	**41.02%**	44.97%	47.12%

Net charge-off rate	**4.96%**	3.88%	3.49%
30+ day delinquency rate	**8.64%**	8.03%	5.72%
Number of total accounts (000s)	**7,381**	7,493	7,199

Table of Contents

The Other National Lending sub-segment consists of the Auto Finance and International sub-segments.

Auto Finance (a sub-segment of Other National Lending)

Table 6: Auto Finance

	As of and for the Year Ended December 31,		
(Dollars in thousands)	**2008**	**2007**	**2006**
Earnings (Managed Basis)			
Interest income	**$ 2,614,967**	$ 2,638,290	$ 2,237,205
Interest expense	**1,087,573**	1,127,421	864,688
Net interest income	**1,527,394**	1,510,869	1,372,517
Non-interest income	**59,235**	112,261	81,384
Total revenue	**1,586,629**	1,623,130	1,453,901
Provision for loan and lease losses	**1,320,515**	1,056,120	494,835
Goodwill impairment charge	**810,876**		
Non-interest expense	**503,942**	618,568	599,807
Income before taxes	**(1,048,704)**	(51,558)	359,259
Income taxes	**(89,759)**	(17,736)	125,740
Net income (loss)	**$ (958,945)**	$ (33,822)	$ 233,519
Selected Metrics (Managed Basis)			
Period end loans held for investment	**$ 21,481,911**	$ 25,128,352	$ 21,751,827
Average loans held for investment	**$ 23,483,706**	$ 24,150,231	$ 20,490,920
Loans held for investment yield	**11.14%**	10.92%	10.92%
Net interest margin	**6.50%**	6.26%	6.70%
Revenue margin	**6.76%**	6.72%	7.10%
Risk adjusted margin	**2.17%**	3.66%	4.82%
Non-interest expense as a % of average loans held for investment	**2.15%**	2.56%	2.93%
Efficiency ratio	**31.76%**	38.11%	41.25%
Net charge-off rate	**4.59%**	3.06%	2.28%
30+ day delinquency rate	**9.91%**	7.84%	6.36%
Auto loan originations	**$ 6,874,340**	$ 13,176,533	$ 12,285,306
Number of total accounts (000s)	**1,634**	1,771	1,589

The Auto Finance sub-segment consists of automobile and other motor vehicle financing activities.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

The Auto Finance sub-segment recognized a net loss of $958.9 million during 2008, compared with a net loss of $33.8 million during 2007. Excluding the $804.4 million after tax impact of the goodwill impairment incurred in the fourth quarter of 2008, the Auto Finance sub-segment recognized a net loss of $154.5 million in 2008, driven primarily by higher credit related expenses due to the worsening economy and the general conditions surrounding the auto industry over the past year.

As a result of the uncertain operating environment, the Auto Finance sub-segment chose to purposefully reduce the size of the loan portfolio from the prior period. Originations in 2008 were $6.9 billion, 48% lower than the prior year, driven by pullbacks across both the dealer and direct channels. Loans held for investment decreased 15% year over year, as the business focused on its most resilient customer segments during these economic challenges.

Despite the significant volume pullbacks over the period, total revenue in 2008 declined only 2% from 2007. Partially offsetting the volume driven revenue impacts was an ability to modestly increase net interest margin as several key competitors pulled back or exited markets over the period.

During 2008, the Auto Finance sub-segment s net charge-off rate was 4.59%, up 153 basis points from 3.06% during 2007. Net charge-offs increased $340.4 million, or 46%, while average loans outstanding during 2008 decreased $666.5 million, or 3%, compared to 2007. Declining auction rates for used vehicles contributed approximately $31.1 million to the increase in net charge-offs. The 30-plus day delinquency rate was 9.91%, up 207 basis points at December 31, 2008 versus prior year. The provision for loan losses increased $264.4 million, or 25% in 2008 driven by further weakening in the U.S. economy, partially offset by the shrinking loan portfolio over the period.

Excluding the goodwill impairment charge, non-interest expense declined by 18.5% over the period, as volume related pullbacks resulted in lower origination and servicing costs, coupled with an overall improvement in efficiency over the period.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

The Auto Finance sub-segment recognized a net loss of $33.8 million during 2007, compared with net income of $233.5 million during 2006, as revenue generated from portfolio growth was more than offset by worsening credit performance.

The loan portfolio increased 16% year over year as a result of the transfer of $1.8 billion of North Fork Bank s auto loans to the Auto Finance sub-segment on January 1, 2007 and strong organic originations growth within our dealer and direct marketing channels. Originations in 2007 were $13.2 billion, 7% higher than prior year. As a result of this portfolio growth, net interest income increased 10% during 2007 compared to 2006.

Non-interest income for 2007 included a one-time gain of $46.2 million related to the sale of 1.8 million shares of DealerTrack.

During 2007, the Auto Finance sub-segment s net charge-off rate was 3.06%, up 78 basis points from 2.28% during 2006. Net charge-offs of loans outstanding increased $272.8 million, or 58%, while average loans outstanding during 2007 grew $3.7 billion, or 18%, compared to 2006. The 30-plus day delinquency rate was up 149 basis points at December 31, 2007. The adverse credit performance was mainly driven by credit normalization following the unusually favorable credit environment in 2006 and elevated losses with weakening U.S. economy. The provision for loan and lease losses increased $561.3 million, or 113% during 2007. This increase was driven by a weakening U.S. economy, growth in the loan portfolio, and elevated losses from discontinued programs in our prime segment, as well as moderately worse credit quality in subprime.

In 2007, Non-interest expense increased 3%, compared to 12% revenue growth. Operating costs as a percent of loans have declined from 2.8% during the first quarter of 2007 to 2.3% during the fourth quarter of 2007 as the Auto Finance sub-segment realized the benefits of the integration of the dealer programs of the legacy Capital One, Onyx, Hibernia, and North Fork auto lending businesses.

Table of Contents

International (a sub-segment of Other National Lending)

Table 7: International

(Dollars in thousands)	As of and for the Year Ended December 31, 2008	2007	2006
Earnings (Managed Basis)			
Interest income	**$ 1,466,737**	$ 1,630,041	$ 1,520,213
Interest expense	**495,343**	571,593	536,096
Net interest income	**971,394**	1,058,448	984,117
Non-interest income	**550,762**	622,308	592,977
Total revenue	**1,522,156**	1,680,756	1,577,094
Provision for loan and lease losses	**646,975**	602,350	696,335
Non-interest expense	**771,317**	867,062	828,331
Income before taxes	**103,864**	211,344	52,428
Income taxes	**35,998**	71,441	21,579
Net income	**$ 67,866**	$ 139,903	$ 30,849
Selected Metrics (Managed Basis)			
Period end loans held for investment	**$ 8,720,642**	$ 11,656,922	$ 11,750,819
Average loans held for investment	**$ 10,570,791**	$ 11,310,239	$ 11,131,001
Loans held for investment yield	**13.88%**	14.41%	13.66%
Net interest margin	**9.19%**	9.36%	8.84%
Revenue margin	**14.40%**	14.86%	14.17%
Risk-adjusted margin	**8.63%**	9.24%	8.43%
Non-interest expense as a % of average loans held for investment	**7.30%**	7.67%	7.44%
Efficiency ratio	**50.67%**	51.59%	52.52%
Net charge-off rate	**5.77%**	5.63%	5.73%
30+ day delinquency rate	**5.51%**	4.79%	4.55%
Purchase volume	**$ 10,800,227**	$ 9,305,307	$ 7,892,897
Number of total accounts (000s)	**5,747**	5,722	5,610

The International sub-segment consists of U.K. and Canada lending activities.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Net income for the International sub-segment decreased 51% from 2007 to 2008. Excluding the $31.3 million net gain on the sale of an interest in Spain booked in Q4 2007, full year net income decreased 38% from 2007. This year over year decline was driven by lower revenue in the U.K. due to lower loans held for investment of $2.9 billion as the business continues to focus its long term strategy on more resilient product offerings, coupled with foreign exchange movements over the period, which accounted for $2.2 billion of the decrease. U.K. non-interest expense declined by 18% from 2007 driven by a continued focus on efficiency and the realization of full year savings from the outsourcing initiative implemented in 2007. Canada s net income rose a modest 2% from 2007 in U.S. dollars and was flat in local currency, primarily due to higher net interest income driven by higher outstandings, offset by a higher provision for loan and lease losses, as economic indicators in the Canadian economy have recently begun to show a spillover effect from the U.S.

The net charge-off rate for the International sub-segment in 2008 was 5.77%, an increase of 14 basis points compared to 5.63% for 2007. The increase in the net charge-off rate is largely the result of worsening credit quality trends in both the U.K. and Canada.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Net income for the International sub-segment increased 354% from 2006 to 2007. Excluding the $31.3 million net gain on the sale of an interest in Spain, net income increased 252% from 2006. Profitability improved year over year in both the Canada and U.K. businesses driven by underlying growth as well as foreign exchange movements over the period. In the U.K., credit conditions eased substantially from 2006, causing a 19% decline in the provision for loan and lease losses. Additionally, the U.K. business saw modest improvements in its efficiency ratio as it implemented several cost initiatives over the period. Our Canadian business saw significant growth from 2006 to 2007, driven by 8% local currency outstandings growth and significant appreciation of the Canadian dollar to the U.S. dollar over the comparison period. This growth, coupled with improvements in both revenue margin and operating efficiency, led to a 40% year-over-year increase in net income.

VIII. Liquidity and Funding

The Company manages liquidity risk to ensure that we can fund asset and loan growth, debt and deposit maturities and withdrawals, and payments of other corporate obligations. To achieve this, the Company s Asset/Liability Management Committee and Finance Committee establish liquidity guidelines to ensure that the Company can withstand significant degradation in the funding markets. The Company seeks to maintain a large liquidity reserve to guard against possible degradation. This reserve is comprised of cash, unencumbered securities available for sale and undrawn committed facilities. The current economic environment could have an adverse impact on our asset values, including our securities available for sale, and impact our ability to borrow funds or engage in securitization transactions. See Section 1A. Risk Factors for additional information.

The Company uses a variety of funding sources to establish a maturity pattern that provides a prudent mixture of short-term and long-term funds. The Company obtains funds through the gathering of deposits, issuing debt and equity securities, and securitizing assets. Further liquidity is available to the Company through committed facilities, including undrawn conduits, FHLB advances and recently enacted government programs.

Cash and Cash Equivalents

The Company held $7.5 billion of cash and cash equivalents at December 31, 2008, compared to $4.8 billion of cash and cash equivalents at December 31, 2007. Cash and cash equivalents provide immediate sources of funds to meet the Company s liquidity needs, including dividend payments and other funding obligations.

Securities Available for Sale

The Company held $31.0 billion in available for sale investment securities, of which $13.7 billion was pledged available-for-sale investment securities at December 31, 2008, compared to $19.8 billion in available for sale investment securities, of which $9.3 billion was pledged available-for-sale investment securities at December 31, 2007. As of December 31, 2008, the weighted average life of the investment securities was approximately 2.6 years. These investment securities provide increased liquidity and flexibility to support the Company s funding requirements.

The Company monitors the available for sale investment securities for other-then-temporary impairment based on a number of criteria, including the size of the unrealized loss position, the duration for which the security has been in a loss position, credit rating, the nature of the investments, current market conditions and the Company s intent and ability to hold the securities until anticipated recovery, which may be upon maturity. The Company recognized other-than-temporary impairment charges of $10.9 million for the year ended December 31, 2008. No other-than-temporary impairment was recognized for the year ended December 31, 2007. The available for sale investment securities had net unrealized losses of $1.1 billion as of December 31, 2008, and net unrealized gains of $22.3 million as of December 31, 2007. The Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity. For additional information see Item 8. Financial Statements and Supplementary Date Notes to the Consolidated Financial Statements Note 4.

Deposits

Deposits have become the Company s largest funding source. Deposits provide a stable, low-cost source of funds that we utilize to fund loan and asset growth and to diversify funding sources. The Company has continued to expand its deposit gathering efforts through its direct and indirect marketing channels, the existing branch network and through de novo branch expansion. These channels offer a broad set of deposit products that include demand deposits, money market deposits, NOW accounts, and certificates of deposit (CDs).

As of December 31, 2008, the Company had $108.6 billion in deposits of which $2.7 billion were held in foreign banking offices and $11.3 billion represented large domestic denomination certificates of $100 thousand or more. The Company s core deposits are comprised of domestic non-interest bearing deposits, NOW accounts, money market deposit accounts, savings accounts, CDs of less than $100,000 and other consumer time deposits. The Company maintains a Grand Cayman branch for issuing Eurodollar time deposits.

The Company has deposits that are obtained through the use of a third-party intermediary. Included in these deposits at December 31, 2008 were brokered deposits of $26.9 billion, compared to $6.9 billion at December 31, 2007. These deposits represented 24.8% and 8.3% of total deposits at December 31, 2008 and 2007, respectively. If these brokered deposits are not renewed at maturity, the Company would use its investment securities and money market instruments in addition to alternative funding sources to fund increases in loans and meet its other liquidity needs. The Federal Deposit Insurance Corporation Improvement Act of 1991 limits the use of brokered deposits to well-capitalized insured depository institutions and, with a waiver from the Federal Deposit Insurance Corporation, to adequately capitalized institutions. At December 31, 2008, the

Banks and the Corporation were well-capitalized as defined under the federal banking regulatory guidelines. Based on the Company s historical access to the brokered deposit market, it expects to replace maturing brokered deposits with new brokered deposits or with the Company s direct deposits. Brokered deposits are included in other consumer time deposits and money market deposit accounts.

Table of Contents

Table 8 shows the maturities of domestic time certificates of deposit in denominations of $100 thousand or more (large denomination CDs) as of December 31, 2008. Based on past deposit activity, the Company expects to retain a portion of its deposit balances as they mature. Therefore, the Company anticipates the net cash outflow related to deposits within the next year will be significantly less than reported in Table 8. Table 9 shows the composition of period end deposits, average deposits and the average deposit rate for the periods presented.

Table 8: Maturities of Large Denomination Certificates $100,000 or More

	December 31, 2008	
(Dollars in thousands)	**Balance**	**Percent**
Three months or less	$ 1,683,153	15.0%
Over 3 through 6 months	1,820,956	16.1%
Over 6 through 12 months	3,319,048	29.5%
Over 12 months through 10 years	4,435,887	39.4%
Total	$ 11,259,044	100.0%

Table 9: Deposit Composition and Average Deposit Rates

	Year Ended December 31, 2008			
	Period End Balance	**Average Balance**	**% of Deposits**	**Average Deposit Rate**
Non-interest bearing	$ 11,293,852	$ 10,772,019	11.52%	N/A
NOW accounts	10,522,219	9,305,767	9.95%	1.29%
Money market deposit accounts	29,171,168	26,216,946	28.04%	2.74%
Savings accounts	7,119,510	7,821,040	8.36%	0.91%
Other consumer time deposits	36,509,357	25,414,506	27.18%	4.13%
Total core deposits	94,616,106	79,530,278	85.05%	2.46%
Public fund certificates of deposit of $100,000 or more	1,174,294	1,415,864	1.52%	2.94%
Certificates of deposit of $100,000 or more	10,084,750	9,119,666	9.75%	4.29%
Foreign time deposits	2,745,639	3,441,838	3.68%	3.52%
Total deposits	$ 108,620,789	$ 93,507,646	100.00%	2.69%

	Year Ended December 31, 2007			
	Period End Balance	**Average Balance**	**% of Deposits**	**Average Deposit Rate**
Non-interest bearing	$ 11,046,549	$ 11,446,706	13.43%	N/A
NOW accounts	9,356,766	9,319,221	10.94%	2.50%
Money market deposit accounts	23,901,637	23,074,931	27.08%	4.31%
Savings accounts	8,071,334	8,327,672	9.77%	1.70%
Other consumer time deposits	16,747,588	17,905,484	21.01%	4.52%
Total core deposits	69,123,874	70,074,014	82.23%	3.11%
Public fund certificates of deposit of $100,000 or more	1,631,253	1,951,412	2.29%	5.09%
Certificates of deposit of $100,000 or more	8,398,095	9,233,313	10.84%	4.62%
Foreign time deposits	3,607,954	3,952,877	4.64%	5.10%

Total deposits	$ 82,761,176	$ 85,211,616	100.00%	3.41%

Table of Contents

	Year Ended December 31, 2006			
	Period End Balance	Average Balance	% of Deposits	Average Deposit Rate
Non-interest bearing	$ 11,648,070	$ 4,906,313	9.72%	N/A
NOW accounts	4,868,874	974,126	1.93%	2.75%
Money market deposit accounts	25,025,123	12,066,857	23.90%	3.46%
Savings accounts	8,455,865	4,248,016	8.41%	2.58%
Other consumer time deposits	19,724,693	14,914,294	29.53%	4.31%
Total core deposits	69,722,625	37,109,606	73.49%	3.23%
Public fund certificates of deposit of $100,000 or more	1,826,993	1,060,748	2.10%	7.33%
Certificates of deposit of $100,000 or more	10,059,043	8,814,475	17.45%	4.19%
Foreign time deposits	3,953,285	3,513,866	6.96%	4.85%
Total deposits	$ 85,561,946	$ 50,498,695	100.00%	3.59%

Additional information regarding funding can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 8 .

Credit Ratings

The Company also meets its liquidity needs by accessing the capital markets for long-term funding by issuing asset-backed securities and senior and subordinated debt. Rating agencies base their ratings on numerous factors, including liquidity, capital adequacy, asset quality and quality of earnings. Significant changes in these factors could result in different ratings. Table 10 provides the senior unsecured debt credit ratings of the Corporation, COBNA and CONA as of December 31, 2008.

Table 10: Senior Unsecured Debt Credit Ratings

	Capital One Financial Corporation	Capital One Bank (USA), N.A.	Capital One, N.A.
Moody s[1]	A3	A2	A2
S&P[1]	BBB+	A-	A-
Fitch, Inc.	A-	A-	A-
Dominion Bond Rating Service	BBB***	A*	A*

(1) As of the date of this report, Moody s and S&P have the Company on a negative outlook.

* low *** high

Loan Securitizations

The Company actively engages in securitization transactions of loans for funding purposes. The Company receives the proceeds from third party investors for securities issued from the Company s securitization vehicles which are collateralized by transferred receivables from the Company s portfolio. The Company removes loans from the reported financial statements for securitizations that qualify as sales in accordance with SFAS 140. Alternatively, when the transfer would not be considered a sale but rather a financing, the assets will remain on the Company s reported financial statements with an offsetting liability recognized in the amount of proceeds received.

The Company s securitizations have maturities from 2009 to 2025. The revolving securitizations have accumulation periods during which principal payments are aggregated to make payments to investors. As payments on the loans are accumulated and are no longer reinvested in new loans, the Company s funding requirements for loans increase accordingly. Securitization transactions may amortize earlier than scheduled due to certain early amortization triggers, which could require the Company to fund spread accounts, reduce the value of its retained residual interests and ultimately require loans that would have been sold off of the balance sheet to remain on the Company s balance

sheet and accelerate the need for alternative funding. Additionally, early amortization of securitization structures would require the Company to record higher reserves for loan and lease losses and would also have a significant impact on the ability of the Company to meet regulatory capital adequacy requirements. As of December 31, 2008, no early amortization events related to the Company s off-balance sheet securitizations have occurred.

The Company believes that it has the ability to continue to utilize securitization arrangements as a source of liquidity; however, a significant reduction, termination or change in sale accounting for the Company s off-balance sheet securitizations could require the Company to draw down existing liquidity and/or to obtain additional funding through the issuance or recognition of secured borrowings or unsecured debt, the raising of additional deposits or the slowing of asset growth to offset or to satisfy liquidity needs. The Company has committed securitization conduits of $12.0 billion, of which, $6.2 billion was outstanding as of December 31, 2008.

Senior and Subordinated Notes

Other funding programs established by the Company include senior and subordinated notes. At December 31, 2008, the Company had $8.3 billion in senior and subordinated notes outstanding that mature in varying amounts from 2009 to 2017, as compared to $10.7 billion at December 31, 2007.

Included in senior and subordinated notes on the Company s balance sheet are notes issued under COBNA s Senior and Subordinated Global Bank Note Program (the Program). The Program gives COBNA the ability to issue securities to both U.S. and non-U.S. lenders and to raise funds in U.S. and foreign currencies, subject to conditions customary for transactions of this nature. Notes may be issued under the Program with maturities of thirty days or more from the date of issue. The Program was last updated in June 2005. At December 31, 2008, COBNA had $1.8 billion in bank notes outstanding under the Program.

Federal Home Loan Bank Advances

The Banks are members of various Federal Home Loan Banks (FHLB). The FHLB provides additional sources of funding through advances to the Banks. The FHLB advances are secured by the Company s securities, residential mortgage loan portfolio, multifamily loans, commercial real estate loans and home equity lines of credit. As of December 31, 2008, the Company had approximately $20.1 billion in securities and loans pledged as collateral to the FHLB. In addition, the Company s FHLB membership is secured by the Company s investment in FHLB stock, which totaled $267.5 million at December 31, 2008 and is included in other assets. Total advances with FHLB agencies at December 31, 2008 were $4.9 billion. During 2008, the Company received $15.4 billion in new advances and had $17.3 billion in advances mature.

Collateralized Revolving Credit Facilities

In March 2002, the Company entered into a revolving warehouse credit facility collateralized by a security interest in certain auto loan assets (the Capital One Auto Loan Facility I). As of December 31, 2008, the Capital One Auto Loan Facility I had the capacity to issue up to $1.05 billion in secured notes. The Capital One Auto Loan Facility I has multiple participants each with separate renewal dates. The facility does not have a final maturity date. Instead, each participant may elect to renew the commitment for another set period of time. Interest on the facility is based on commercial paper rates. The Capital One Auto Loan Facility I was paid down in January 2008.

In March 2005, the Company entered into a second revolving warehouse credit facility collateralized by a security interest in certain auto loan assets (the Capital One Auto Loan Facility II). As of December 31, 2008, the Capital One Auto Loan Facility II had the capacity to issue up to $0.5 billion in secured notes. The facility does not have a final maturity date. Instead, the participant may elect to renew the commitment for another set period of time. Interest on the facility is based on commercial paper rates. The Capital One Auto Loan Facility II was paid down in January 2008.

Government Programs

The Company is eligible or may be eligible to participate in a number of U.S. government programs designed to support financial institutions and increase access to credit markets. The Company evaluates each of these programs and determines, based on the costs and benefits of each program, whether to participate. During 2008, the Company participated in or was eligible to participate in the U.S. Treasury Department s Capital Purchase Program (CPP), the FDIC s Temporary Liquidity Guarantee Program (TLGP), the Federal Reserve s Discount Window (the Discount Window) and the Federal Reserve s Term Auction Facility (TAF).

U.S. Treasury Department s Capital Purchase Program

On October 27, 2008, the Company announced its intention to take part in the CPP. On November 14, 2008 the Company entered into an agreement (the Securities Purchase Agreement) to issue 3,555,199 Fixed Rate Cumulative Perpetual Preferred Shares, Series A, par value $0.01 per share, liquidation preference $1,000 per share (the Series A Preferred Stock), to the U.S. Treasury as part of the

Table of Contents

Company s participation in the CPP. The Series A Preferred Stock pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year. In addition, the Company issued a warrant (the Warrant) to purchase 12,657,960 of the Company s common shares to the U.S. Treasury as part of the Securities Purchase Agreement. The Company received proceeds of $3.55 billion for the Series A Preferred Stock and the Warrant.

FDIC s Temporary Liquidity Guarantee Program

As of December 31, 2008, the Company is a participant in the FDIC s TLGP. The TLGP is comprised of the Debt Guarantee Program (DGP) and the Transaction Account Guarantee Program (TAGP). For further information regarding the TLGP and TAGP see Item 1 Supervision and Regulation .

The DGP provides an FDIC guarantee of certain senior unsecured debt of FDIC-insured institutions and their holding companies. The unsecured debt must be issued on or after October 14, 2008 and not later than October 31, 2009, and the guarantee is effective through the earlier of the maturity date or June 30, 2012. The DGP coverage limit is generally 125% of the eligible entity s eligible debt outstanding on September 30, 2008 and scheduled to mature on or before June 30, 2009 or, for certain insured institutions, 2% of their liabilities as of September 30, 2008. Based on the Company s outstanding senior unsecured debt as of September 30, 2008, the Company has capacity to issue $1.2 billion under the DGP. As of December 31, 2008, the Company has not issued any debt under the DGP.

Federal Reserve s Discount Window

The Federal Reserve s Discount Window allows eligible institutions to borrow funds from the Federal Reserve, typically on a short-term basis, to meet temporary liquidity needs. Borrowers must post collateral, which can be made up of securities or consumer or commercial loans. As of December 31, 2008, the Company was eligible to borrow up to $4.2 billion through the Discount Window. The eligible amount is reduced dollar for dollar by borrowings under the TAF program. During 2008, the Company did not borrow funds from the Discount Window.

Federal Reserve s Term Auction Facility

The Federal Reserve s TAF is designed to help increase liquidity in the U.S. credit markets. The Federal Reserve auctions collateral-backed short-term loans under TAF. The auctions allow financial institutions to borrow funds at an interest rate below the Federal Reserve s discount rate. As of December 31, 2008, the Company was eligible to borrow up to $2.1 billion under the TAF. The eligible amount is reduced dollar for dollar by borrowings made under the Discount Window. During 2008, the Company did not borrow funds through the TAF.

Term Asset-Backed Securities Loan Facility

In December of 2008, the Federal Reserve Bank of New York (FRBNY), the U.S. Treasury and the Federal Reserve Board announced its intentions to launch the Term Asset-Backed Securities Loan Facility (TALF). TALF is a funding facility that will help financial markets and institutions meet the credit needs of households and small businesses and thus to support overall economic growth in the current period of severe financial strains by supporting the issuance of asset-backed securities (ABS) collateralized by student loans, auto loans, credit card loans, loans guaranteed by the Small Business Administration (SBA), as well as certain types of mortgage loans. Under the current specification of the TALF, the FRBNY will lend up to $1 trillion on a non-recourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans, as well as commercial mortgage-backed securities, private-label residential mortgage-backed securities, and other asset-backed securities. The FRBNY will lend an amount equal to the market value of the ABS less a haircut and will be secured at all times by the ABS. The U.S. Treasury will provide credit protection to the FRBNY in connection with the TALF. As of the date of this report, it is expected that TALF will commence operations during March 2009. As of the date of this report it is undetermined whether the Company will desire to participate in the TALF program. Such determination will be made after the final terms and conditions of TALF are released.

Funding Obligations

Information regarding the Company s funding obligations is disclosed in Tables 11 and 12. Table 11 reflects the costs of short term borrowings of the Company as of and for each of the years ended December 31, 2008, 2007 and 2006. Table 12 summarizes the amounts and maturities of the contractual funding obligations of the Company, including off-balance sheet funding obligations.

Table of Contents

Table 11: Short Term Borrowings

(Dollars in Thousands)	Maximum Outstanding as of any Month-End	Outstanding as of Year-End	Average Outstanding	Average Interest Rate	Year-End Weighted Average Interest Rate
2008:					
Federal funds purchased and resale agreements	**$ 6,311,810**	**$ 832,961**	**$ 3,261,190**	**1.90%**	**.0007%**
Other[1]	**4,964,750**		**351,960**	**7.83**	**N/A**
Total		**$ 832,961**	**$ 3,613,150**	**2.48%**	**.0007%**
2007:					
Federal funds purchased and resale agreements	$ 3,504,745	$ 683,186	$ 1,689,647	4.74%	3.19%
Other	4,345,490	4,345,490	2,635,113	5.91	5.88
Total		$ 5,028,676	$ 4,324,760	5.45%	5.51%
2006:					
Federal funds purchased and resale agreements	$ 3,736,470	$ 3,736,470	$ 1,662,961	4.20%	5.27%
Other	3,198,710	1,716,055	1,323,998	5.75	5.89
Total		$ 5,452,525	$ 2,986,959	4.89%	5.28%

(1) In 2008, the Company repaid certain borrowings under lines of credit associated with securitizations of auto consumer loans.

Table 12 summarizes the amounts and maturities of the contractual funding obligations of the Company, including off-balance sheet funding.

Table 12: Contractual Funding Obligations

As of December 31, 2008	Total	Up to 1 year	1-3 years	4-5 years	After 5 years
Interest-bearing time deposits[1]	$ 47,125,682	$ 16,285,419	$ 19,510,165	$ 8,714,897	$ 2,615,201
Senior and subordinated notes	8,308,843	1,447,245	1,626,511	1,483,635	3,751,452
Other borrowings[2]	14,869,648	4,995,418	8,064,669	8,908	1,800,653
Operating leases	1,231,829	132,780	241,673	222,935	634,441
Off-balance sheet securitization amortization[3]	44,299,597	6,932,463	20,677,117	8,026,987	8,663,030
Total obligations	$ 115,835,599	$ 29,793,325	$ 50,120,135	$ 18,457,362	$ 17,464,777

(1) Includes only those interest bearing deposits which have a contractual maturity date.
(2) Other borrowings includes secured borrowings for the Company s on-balance sheet auto loan securitizations, junior subordinated capital income securities and debentures, FHLB advances, federal funds purchased and resale agreements and other short-term borrowings.
(3) Includes scheduled maturities of the external investors interest in securitizations.

Corporation Shelf Registration Statement

As of December 31, 2008, the Corporation had an effective shelf registration statement under which the Corporation from time to time may offer and sell an indeterminate aggregate amount of senior or subordinated debt securities, preferred stock, depositary shares representing preferred stock, common stock, warrants, trust preferred securities, junior subordinated debt securities, guarantees of trust preferred securities and certain back-up obligations, purchase contracts and units. There is no limit under this shelf registration statement to the amount or number of such securities that the Corporation may offer and sell. Under SEC rules, the Automatic Shelf Registration Statement expires three years after filing. Accordingly, the Corporation must file a new Automatic Shelf Registration Statement at least once every three years. The Automatic Shelf Registration Statement must be updated by May 2009 to remain effective.

Borrowing Capacity

The Company has access to a variety of established funding sources. Table 13 illustrates details of the Company s Global Bank Note Program, FHLB Advance capacity, securitization warehouses and conduits and government programs as of December 31, 2008.

64

Table 13: Borrowing Capacity

(Dollars or dollar equivalents in millions)	Effective/ Issue Date	Capacity (1)	Outstanding	Availability(1)	Final Maturity(2)
Senior and Subordinated Global Bank Note Program	6/05	$ 3,561	$ 1,761	$ 1,800	
FHLB Advances(3)		$ 12,733	$ 4,877	$ 7,856	
Capital One Auto Loan Facility I	3/02	$ 1,050	$	$ 1,050	
Capital One Auto Loan Facility II	3/05	$ 500	$	$ 500	
Committed Securitization Conduits(4)		$ 12,020	$ 6,173	$ 5,847	09/11
FDIC Debt Guarantee Program		$ 1,200	$	$ 1,200	06/12
Federal Reserve Discount Window		$ 4,200	$	$ 4,200	
Federal Reserve Term Auction Facility		$ 2,100	$	$ 2,100	

(1) All funding sources are non-revolving except for the Capital One Auto Loan Facilities. Funding availability under all other sources is subject to market conditions. Capacity is the maximum amount that can be borrowed. Availability is the amount that can still be borrowed against the facility.
(2) Maturity date refers to the date the facility terminates, where applicable.
(3) There are no effective or final maturity dates on the available lines for FHLB Advances. The ability to draw down funding is based on membership status, and the amount is dependent upon the Banks ability to post collateral.
(4) Securitization committed capacity was established at various dates and is scheduled to terminate between 03/09 and 09/11.

Covenants

In connection with the issuance of certain of its trust preferred capital securities, the Company has entered into a Replacement Capital Covenant (RCC) granting certain rights to the holders of covered debt, as defined in the RCC, that prohibit the repayment, redemption or purchase of the trust preferred capital securities except, with limited exceptions, to the extent that the Company has received specified amounts of proceeds from the sale of certain qualifying securities. Currently, the Company s covered debt is its 5.35% Subordinated Notes due May1, 2014. For more information regarding this covenant, reference is made to the RCC entered into by the Corporation in connection with the issuances of such trust preferred capital securities, which are filed with the U.S. Securities and Exchange Commission under cover of Forms 8-K. The Company will provide a copy of the RCC to holders of the covered debt upon request made to Investor Relations.

The terms of the lease and credit facility agreements related to certain other borrowings and operating leases in Table 12 require several financial covenants (including performance measures and equity ratios) to be met. If these covenants are not met, there may be an acceleration of the payment due dates noted above. As of December 31, 2008, the Company was not in default of any such covenants.

Equity

The Company may also access the equity markets from time to time to raise additional liquidity. During 2008 the Company issued approximately 15.5 million common shares in a secondary offering, raising $760.8 million in 2008.

The Company, as noted above, issued 3,555,199 preferred shares to the U.S. Treasury under the CPP, raising $3.55 billion in 2008.

IX. Market Risk Management

Interest Rate Risk

The management of interest rate risk, or the risk that earnings will be diminished by changes in interest rates, is fundamental for banking institutions. Like other banks, the Company borrows money from other institutions and depositors, which it uses to make loans to customers and to invest in debt securities and other earning assets. The Company earns interest on these loans and assets and pays interest on the money it borrows from institutions and depositors. If the rate of interest it pays on its borrowings and deposits increases more than the rate of interest it earns on its assets, the Company s net interest income, and therefore its earnings, will be diminished. The Company s earnings could also be negatively impacted if the interest rates it charges on its earning assets fall more quickly than the rates it pays on its borrowings and deposits.

Changes in interest rates and competitor responses to those changes may affect the rate of customer payments or pre-payments for mortgages and auto and installment loans and commercial loans and may affect the balances customers carry on their credit cards. These changes can reduce the overall yield on its earning asset portfolio. Changes in interest rates and competitor responses to these changes may also impact customer decisions to maintain balances in the deposit accounts they have with the Company. These changes may require the Company to replace withdrawn balances with higher cost alternative sources of funding.

Table of Contents

In addition to the impact to current earnings, interest rate risk also refers to changes in the net present value of assets and off-balance sheet positions less liabilities (termed economic value of equity) due to interest rate changes. Economic value of equity could be affected to the extent that the market value of the Company s assets, liabilities and off-balance sheet positions do not respond equally to changes in interest rates.

The Company s measurement of interest rate risk considers both earnings and market value exposures. The consolidated balance sheet and all off-balance sheet positions are included in the analysis. The analysis reflects known balances and contractual maturities when available. Balance sheet positions lacking contractual maturities and those with a likelihood of maturity prior to their contractual term are assumed to mature consistent with business line expectations or, when available in the case of marketable securities, market expectations. As of December 31, 2008, the Company s Asset/Liability Management Policy limited the change in projected 12-month earnings due to a gradual +/-200 basis points change in interest rates over the course of nine months to less than 5% of base net interest income. The measurement of impact to current earnings includes the change in net interest income and the change in the valuation of mortgage servicing rights driven by the change in interest rates. Given the absolute low level of interest rates that prevailed as of December 31, 2008 and the inability for market rates to fall below 0%, the declining rate scenario reflects a gradual 50 basis point rate decline versus the customary 200 basis point scenario. As of December 31, 2008 the Company estimated a 0.4% increase in 12-month net interest income for a gradual 200 basis point rate increase and a 0.2% reduction in 12-month net interest income for a gradual 50 basis point rate decline.

In addition to limits related to possible changes in 12-month net interest income, as of December 31, 2008 the Asset/Liability Management Policy limited the pre-tax change in economic value of equity due to instantaneous parallel rate shocks of 200 basis points to less than 12%. As of December 31, 2008, the estimated reduction in economic value of equity due to an adverse 200 basis point rate shock was 4.3%.

The precision of the measures used to manage interest rate risk is limited due to the inherent uncertainty of the underlying forecast assumptions. These measures do not consider the impact of the effects of changes in the overall level of economic activity associated with various interest rate scenarios. In addition, the measurement of interest rate sensitivity includes assumptions on the ability of management to take action to mitigate further exposure to changes in interest rates, including, within legal and competitive constraints, the re-pricing of interest rates on outstanding credit card loans and deposits.

The Company manages and mitigates its interest rate sensitivity through several techniques, which include, but are not limited to, changing the maturity and re-pricing characteristics of various balance sheet categories and by entering into interest rate derivatives.

Table 14 reflects the interest rate repricing schedule for earning assets and interest-bearing liabilities as of December 31, 2008.

Table 14: Interest Rate Sensitivity

	As of December 31, 2008 Subject to Repricing			
(Dollars in Millions)	**Within 180 Days**	**>180 Days- 1 Year**	**>1 Year- 5 Years**	**Over 5 Years**
Earning assets:				
Federal funds sold and resale agreement	$ 637	$	$	$
Interest-bearing deposits at other banks	4,807			
Securities available for sale	10,641	3,265	16,158	939
Mortgage loans held for sale[(1)]	15	11	54	14
Other	2,366			
Loans held for investment	42,858	11,956	41,403	4,801
Total earning assets	61,324	15,232	57,615	5,754
Interest-bearing liabilities:				
Interest-bearing deposits	63,628	12,698	18,794	2,207
Senior and subordinated notes	1,444		2,931	3,934
Other borrowings	9,337	626	3,239	1,668
Total interest-bearing liabilities	74,409	13,324	24,964	7,809
Non-rate related net items	11,308	(103)	(1,725)	3,946

Interest sensitivity gap	(1,778)	1,805	30,927	1,891
Impact of swaps	5,519	(2,549)	(5,611)	2,641
Impact of consumer loan securitizations	(6,061)	(1,152)	3,702	1,207
Interest sensitivity gap adjusted for impact of securitizations and swaps	(2,320)	408	29,018	5,739

Table of Contents

	As of December 31, 2008 Subject to Repricing			
(Dollars in Millions)	Within 180 Days	>180 Days- 1 Year	>1 Year- 5 Years	Over 5 Years
Adjusted gap as a percentage of managed assets	(1.11)%	0.19%	13.83%	2.73%
Adjusted cumulative gap	(165)	1,912	27,106	32,845
Adjusted cumulative gap as a percentage of managed assets	(1.11)%	(0.91)%	12.92%	15.65%

(1) Mortgage loans held for sale line item excludes the related lower of cost or market adjustments.

Foreign Exchange Risk

The Company is exposed to changes in foreign exchange rates which may impact translated income and expense associated with foreign operations. In order to limit earnings exposure to foreign exchange risk, the Company s Asset/Liability Management Policy requires that material foreign currency denominated transactions be hedged. As of December 31, 2008, the estimated reduction in 12-month earnings due to adverse foreign exchange rate movements corresponding to a 95% probability is less than 2%. The precision of this estimate is also limited due to the inherent uncertainty of the underlying forecast assumptions.

Derivative Instruments

The Company enters into interest rate swap agreements in order to manage interest rate exposure. In most cases, this exposure is related to the funding of fixed rate assets with floating rate obligations, including off-balance sheet securitizations. The Company also enters into forward foreign currency exchange contracts to reduce sensitivity to changing foreign currency exchange rates. The hedging of foreign currency exchange rates is limited to certain intercompany obligations related to international operations. These derivatives expose the Company to certain credit risks. The Company has established policies and limits, as well as collateral agreements, to manage credit risk related to derivative instruments.

Additional information regarding derivative instruments can be found in Item 8 Financial Statements and Supplementary Data Notes to the Consolidated Financial Statements Note 17 .

X. Capital

Federal Reserve and OCC Capital Standards

The Company is subject to capital adequacy guidance adopted by the Federal Reserve, and CONA and COBNA are subject to capital adequacy guidelines adopted by the OCC. The capital adequacy guidelines set minimum risk-based and leverage capital requirements that are based on quantitative and qualitative measures of their assets and off-balance sheet items. The Federal Reserve holds the Company to similar minimum capital requirements. Failure to meet minimum capital requirements can result in possible additional, mandatory or discretionary actions by the regulators that, if undertaken, could have a material adverse effect on the Company s consolidated financial statements.

Under these guidelines, a bank s or a holding company s assets and certain specified off-balance sheet commitments and obligations are assigned to various risk categories. A bank s or holding company s capital, in turn, is classified in one of three tiers. Tier 1 capital includes, among other things, common equity, non-cumulative perpetual preferred stock, an eligible amount of cumulative perpetual preferred stock at the holding company level, and minority interests in equity accounts of consolidated subsidiaries, less goodwill and certain other deductions. Tier 2 capital includes, among other things, perpetual preferred stock not qualified as Tier 1 capital, a certain amount of subordinated debt and the allowable portion of allowances for loan and lease losses, subject to certain limitations. Tier 3 capital includes qualifying unsecured subordinated debt.

Banks and bank holding companies currently are required to maintain Tier 1 capital and the sum of Tier 1 and Tier 2 capital equal to at least 4% and 8%, respectively, of their total risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit). The federal banking agencies, however, may set higher capital requirements for an individual bank or bank holding company when a bank s particular circumstances warrant.

The federal banking agencies also require incorporation of market components into regulatory capital computations. Under the market risk requirements, capital is allocated to support the amount of market risk related to a financial institution s ongoing trading activities.

In addition, the federal banking agencies have established minimum leverage (Tier 1 capital to adjusted average total assets) guidelines for banks within their regulatory jurisdiction. These guidelines provide for a minimum leverage ratio of 3% for banks that meet certain specified criteria, including excellent asset quality, high liquidity, low interest rate exposure and the highest regulatory rating. Banks not meeting these criteria are required to maintain a leverage ratio of 4%.

Table of Contents

From time to time, the regulators propose changes and amendments to, and issue interpretations of, risk-based capital guidelines and related reporting instructions. Such proposals or interpretations could, if implemented in the future, affect the Company s or each of the Bank s reported capital ratios and net risk-adjusted assets. For additional information on capital guidelines, see Part I, Item 1 Supervision and Regulation.

As of December 31, 2008, the Banks each exceeded the minimum regulatory requirements to which it was subject. Each of the Banks was considered well-capitalized under applicable capital adequacy guidelines. Also as of December 31, 2008, the Company was considered well-capitalized under Federal Reserve capital standards for bank holding companies and, therefore, exceeded all minimum capital requirements. There have been no conditions or events since that we believe would have changed the capital category of the Company or either of the Banks.

Failure to meet applicable capital guidelines could subject the Company or the Banks to a variety of enforcement remedies available to the regulators, including a limitation on the ability to pay dividends and the issuance of a capital directive to increase capital, and in the case of the Banks, the termination of deposit insurance by the FDIC (in severe cases) and the appointment of a conservator or receiver. Failure to meet these capital guidelines could also prevent the Company or the Banks from engaging in the expanded activities permitted for bank holding companies and banks under the Gramm-Leach-Bliley Act.

Prompt Corrective Action

In general, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) subjects banks to significantly increased regulation and supervision. Among other things, FDICIA requires federal banking agencies to take prompt corrective action in respect of banks that do not meet minimum capital requirements. FDICIA establishes five capital ratio levels: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. Under applicable regulations, a bank is considered to be well-capitalized if it maintains a total risk-based capital ratio of at least 10%, a Tier 1 risk-based capital ratio of at least 6%, a Tier 1 leverage capital ratio of at least 5% and is not subject to any supervisory agreement, order, or directive to meet and maintain a specific capital level for any capital reserve. A bank is considered to be adequately capitalized if it maintains a total risk-based capital ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 4%, a Tier 1 leverage capital ratio of at least 4% (3% for certain highly rated institutions), and does not otherwise meet the well-capitalized definition. The three undercapitalized categories are based upon the amount by which a bank falls below the ratios applicable to adequately capitalized institutions. The capital categories are determined solely for purposes of applying FDICIA s prompt corrective action provisions, as discussed below, and such capital categories may not constitute an accurate representation of each of the Bank s overall financial condition or prospects. As of December 31, 2008, COBNA and CONA each met the requirements for a well capitalized institution.

Under FDICIA s prompt corrective action system, a bank in the undercapitalized category must submit a capital restoration plan guaranteed by its parent company. The liability of the parent company under any such guarantee is limited to the lesser of 5% of the bank s assets at the time it became undercapitalized, or the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time the institution fails to comply with the plan. A bank in the undercapitalized category also is subject to limitations in numerous areas including, but not limited to, asset growth, acquisitions, branching, new business lines, acceptance of brokered deposits and borrowings from the Federal Reserve. Progressively more burdensome restrictions are applied to banks in the undercapitalized category that fail to submit or implement a capital plan and to banks that are in the significantly undercapitalized or critically undercapitalized categories. In addition, a bank s primary federal banking agency is authorized to downgrade the bank s capital category to the next lower category upon a determination that the bank is in an unsafe or unsound condition or is engaged in an unsafe or unsound practice. An unsafe or unsound practice can include receipt by the institution of a less than satisfactory rating on its most recent examination with respect to its asset quality, management, earnings or liquidity. Critically undercapitalized institutions are subject to the appointment of a receiver or conservator. Under FDICIA, absent an FDIC exemption, from the date 60 days after an institution becomes or is deemed to become critically undercapitalized it may not make any payments of principal or interest on its subordinated debt.

As an additional means to identify problems in the financial management of depository institutions, FDICIA requires regulators to establish certain non-capital safety and soundness standards. The standards relate generally to operations and management, asset quality, interest rate exposure and executive compensation. The agencies are authorized to take action against institutions that fail to meet such standards.

Subprime Lending Guidelines

As discussed in the Supervision and Regulation section on page 10, COBNA treats a portion of its loans as subprime under the Guidelines issued by the four federal banking agencies that comprise the Federal Financial Institutions Examination Council (FFIEC), and have assessed its capital and allowance for loan and lease losses accordingly.

Under the Guidelines, COBNA exceeded the minimum capital adequacy guidelines as of December 31, 2008. Also, as of December 31, 2008, none of CONA s on-balance sheet assets were treated as subprime for purposes of the Subprime Guidelines.

Dividend Policy

The declaration and payment of dividends, as well as the amount thereof, are subject to the discretion of the Board of Directors of the Company and will depend upon our results of operations, financial condition, cash requirements, future prospects and other factors deemed relevant by the Board of Directors. As a holding company, our ability to pay dividends is largely dependent upon the receipt of dividends or other payments from our subsidiaries. Regulatory restrictions exist that limit the ability of COBNA and CONA to transfer funds to the Company. As of December 31, 2008, retained earnings of COBNA and CONA of $239.3 million and zero, respectively, were available for payment of dividends to the Company without prior approval by the regulators. Additionally, applicable provisions that may be contained in our borrowing agreements or the borrowing agreements of our subsidiaries may limit our subsidiaries ability to pay dividends to us or our ability to pay dividends to our stockholders. There can be no assurance that the Company will declare and pay any dividends. In addition, U.S. Treasury consent is required to increase our dividend above its current quarterly level of $0.375 per share until November 14, 2011, under the terms of the CPP.

Table of Contents

XI. Tabular Summary

TABLE A STATEMENTS OF AVERAGE BALANCES, INCOME AND EXPENSE, YIELDS AND RATES

Table A provides average balance sheet data and an analysis of net interest income, net interest spread (the difference between the yield on earning assets and the cost of interest-bearing liabilities) and net interest margin for the years ended December 31, 2008, 2007 and 2006.

	Year Ended December 31								
	2008			2007(2)			2006(2)		
(Dollars in Thousands)	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Assets:									
Earning assets									
Consumer loans(1)									
Domestic	**$ 57,778,303**	**$ 6,531,101**	**11.30%**	$ 56,565,058	$ 6,601,387	11.67%	$ 47,427,119	$ 5,986,533	12.62%
International	**3,442,045**	**444,691**	**12.92%**	3,471,453	436,368	12.57%	3,842,113	433,126	11.27%
Total consumer loans	**61,220,348**	**6,975,792**	**11.39%**	60,036,511	7,037,755	11.72%	51,269,232	6,419,659	12.52%
Commercial loans	**37,750,555**	**2,484,586**	**6.58%**	33,505,314	2,462,373	7.35%	12,308,047	626,814	5.09%
Total loans held for investment(4)	**98,970,903**	**9,460,378**	**9.56%**	93,541,825	9,500,128	10.16%	63,577,279	7,046,473	11.08%
Securities available for sale	**25,042,506**	**1,224,012**	**4.89%**	18,933,750	950,972	5.02%	14,686,556	676,712	4.61%
Other									
Domestic(3)	**8,030,295**	**406,240**	**5.06%**	7,792,357	573,158	7.36%	4,716,374	391,351	8.30%
International	**1,039,940**	**21,369**	**2.05%**	1,152,497	53,898	4.68%	1,106,527	50,199	4.54%
Total(3)	**9,070,235**	**427,609**	**4.71%**	8,944,854	627,056	7.01%	5,822,901	441,550	7.58%
Total earning assets(3)	**$ 133,083,644**	**$ 11,111,999**	**8.35%**	121,420,429	$ 11,078,156	9.12%	84,086,736	$ 8,164,735	9.71%
Cash and due from banks(3)	**2,127,961**			2,112,587			1,680,104		
Allowance for loan and lease losses(3)	**(3,266,768)**			(2,182,667)			(1,791,172)		
Premises and equipment, net(3)	**2,317,383**			2,250,117			1,469,807		