

CAPITAL ONE FINANCIAL CORP
Form 10-Q
November 10, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended September 30, 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)

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Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

54-1719854
(I.R.S. Employer
Identification No.)

1680 Capital One Drive McLean, Virginia
(Address of Principal Executive Offices)

(703) 720-1000

22102
(Zip Code)

Registrant's telephone number, including area code:

(Not applicable)

(Former name, former address and former fiscal year, if changed since last report)

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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b of the Exchange Act. (Check One):

Large accelerated filer 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

As of October 31, 2008 there were 391,658,174 shares of the registrant's Common Stock, par value \$.01 per share, outstanding.

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CAPITAL ONE FINANCIAL CORPORATION

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Table of Contents**Part 1. Financial Information****Item 1. Financial Statements****CAPITAL ONE FINANCIAL CORPORATION****Consolidated Balance Sheets****(Dollars in thousands, except share and per share data) (unaudited)**

	September 30, 2008	December 31, 2007
Assets:		
Cash and due from banks	\$ 3,511,558	\$ 2,377,287
Federal funds sold and resale agreements	1,435,521	1,766,762
Interest-bearing deposits at other banks	673,662	677,360
Cash and cash equivalents	5,620,741	4,821,409
Securities available for sale	26,969,471	19,781,587
Mortgage loans held for sale	98,900	315,863
Loans held for investment	97,965,351	101,805,027
Less: Allowance for loan and lease losses	(3,519,610)	(2,963,000)
Net loans held for investment	94,445,741	98,842,027
Accounts receivable from securitizations	4,980,823	4,717,879
Premises and equipment, net	2,305,286	2,299,603
Interest receivable	750,717	839,317
Goodwill	12,815,642	12,830,740
Other	6,815,792	6,141,944
Total assets	\$ 154,803,113	\$ 150,590,369
Liabilities:		
Non-interest-bearing deposits	\$ 10,665,286	\$ 11,046,549
Interest-bearing deposits	88,247,688	71,714,627
Total deposits	98,912,974	82,761,176
Senior and subordinated notes	8,278,856	10,712,706
Other borrowings	15,962,072	26,812,969
Interest payable	508,091	631,609
Other	5,529,580	5,377,797
Total liabilities	129,191,573	126,296,257
Stockholders Equity:		
Preferred stock, par value \$.01 per share; authorized 50,000,000 shares, none issued or outstanding		
Common stock, par value \$.01 per share; authorized 1,000,000,000 shares, 438,305,214 and 419,224,900 issued as of September 30, 2008 and December 31, 2007, respectively	4,383	4,192
Paid-in capital, net	16,752,078	15,860,490
Retained earnings	12,222,170	11,267,568
Cumulative other comprehensive income (loss)	(201,680)	315,248

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Less: Treasury stock, at cost; 46,621,721 shares and 46,370,635 shares as of September 30, 2008 and December 31, 2007, respectively	(3,165,411)	(3,153,386)
Total stockholders' equity	25,611,540	24,294,112
Total liabilities and stockholders' equity	\$ 154,803,113	\$ 150,590,369

See Notes to Consolidated Financial Statements.

Table of Contents**CAPITAL ONE FINANCIAL CORPORATION****Consolidated Statements of Income****(Dollars in thousands, except per share data) (unaudited)**

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Interest Income:				
Loans held for investment, including past-due fees	\$ 2,347,480	\$ 2,381,096	\$ 7,153,582	\$ 6,963,349
Securities available for sale	317,274	252,550	856,110	694,608
Other	107,042	133,321	333,486	460,005
Total interest income	2,771,796	2,766,967	8,343,178	8,117,962
Interest Expense:				
Deposits	624,319	740,091	1,827,284	2,220,177
Senior and subordinated notes	96,568	144,643	352,335	417,250
Other borrowings	244,264	257,759	817,241	712,937
Total interest expense	965,151	1,142,493	2,996,860	3,350,364
Net interest income	1,806,645	1,624,474	5,346,318	4,767,598
Provision for loan and lease losses	1,093,917	595,534	3,002,119	1,342,292
Net interest income after provision for loan and lease losses	712,728	1,028,940	2,344,199	3,425,306
Non-Interest Income:				
Servicing and securitizations	875,718	1,354,303	2,793,520	3,569,281
Service charges and other customer-related fees	576,762	522,374	1,675,032	1,484,820
Mortgage servicing and other	39,183	52,661	90,990	172,476
Interchange	148,076	103,799	432,708	347,889
Other	57,152	116,525	383,435	321,417
Total non-interest income	1,696,891	2,149,662	5,375,685	5,895,883
Non-Interest Expense:				
Salaries and associate benefits	571,686	627,358	1,761,538	1,970,433
Marketing	267,372	332,693	853,265	989,654
Communications and data processing	176,720	194,551	559,065	569,405
Supplies and equipment	126,781	134,639	389,649	384,971
Occupancy	96,483	77,597	264,700	230,835
Restructuring expense	15,306	19,354	81,625	110,428
Other	555,858	548,029	1,542,242	1,687,077
Total non-interest expense	1,810,206	1,934,221	5,452,084	5,942,803
Income from continuing operations before income taxes	599,413	1,244,381	2,267,800	3,378,386
Income taxes	213,624	428,010	786,958	1,108,279
Income from continuing operations, net of tax	385,789	816,371	1,480,842	2,270,107
Loss from discontinued operations, net of tax	(11,650)	(898,029)	(105,294)	(926,343)
Net income (loss)	\$ 374,139	\$ (81,658)	\$ 1,375,548	\$ 1,343,764

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Basic earnings per share:

Income from continuing operations	\$	1.03	\$	2.11	\$	3.98	\$	5.74
Loss from discontinued operations		(0.03)		(2.32)		(0.28)		(2.34)
Net income (loss)	\$	1.00	\$	(0.21)	\$	3.70	\$	3.40

Diluted earnings per share:

Income from continuing operations	\$	1.03	\$	2.09	\$	3.96	\$	5.66
Loss from discontinued operations		(0.03)		(2.30)		(0.28)		(2.31)
Net income (loss)	\$	1.00	\$	(0.21)	\$	3.68	\$	3.35
Dividends paid per share	\$	0.375	\$	0.03	\$	1.125	\$	0.08

See Notes to Consolidated Financial Statements.

Table of Contents**CAPITAL ONE FINANCIAL CORPORATION****Consolidated Statements of Changes in Stockholders' Equity****(Dollars in thousands, except per share data) (unaudited)**

(In Thousands, Except Per Share Data)	Common Stock			Retained Earnings	Cumulative	Treasury Stock	Total Stockholders' Equity
	Shares	Amount	Paid-In Capital, Net		Other Comprehensive Income (Loss)		
Balance, December 31, 2006	412,219,973	\$ 4,122	\$ 15,333,137	\$ 9,760,184	\$ 266,180	\$ (128,417)	\$ 25,235,206
Cumulative effect from adoption of FIN 48				(31,830)			(31,830)
Cumulative effect from adoption of FAS 156, net of income taxes of \$6,378				8,809			8,809
Comprehensive income:							
Net income				1,343,764			1,343,764
Other comprehensive income, net of income tax:							
Unrealized loss on securities, net of income taxes benefit of \$5,436					(1,560)		(1,560)
Defined benefit pension plans					(2,028)		(2,028)
Foreign currency translation adjustments					127,754		127,754
Unrealized losses on cash flow hedging instruments, net of income tax of \$22,833					(44,162)		(44,162)
Other comprehensive income					80,004		80,004
Comprehensive income							1,423,768
Cash dividends—\$.08 per share				(31,885)			(31,885)
Purchase of treasury stock						(2,252,665)	(2,252,665)
Issuances of common stock and restricted stock, net of forfeitures	1,234,190	13	28,023				28,036

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(In Thousands, Except Per Share Data)	Common Stock		Paid-In Capital, Net	Retained Earnings	Cumulative Other		Total Stockholders Equity
	Shares	Amount			Comprehensive Income (Loss)	Treasury Stock	
Exercise of stock options and related tax benefits of exercises and restricted stock vesting	5,030,089	49	273,708				273,757
Compensation expense for restricted stock awards and stock options			139,379				139,379
Adjustment to issuance of common stock for acquisition	(137,258)	(1)	(10,463)				(10,464)
Allocation of ESOP shares			4,741				4,741
Balance, September 30, 2007	418,346,994	\$ 4,183	\$ 15,768,525	\$ 11,049,042	\$ 346,184	\$ (2,381,082)	\$ 24,786,852
Balance, December 31, 2007	419,224,900	\$ 4,192	\$ 15,860,490	\$ 11,267,568	\$ 315,248	\$ (3,153,386)	\$ 24,294,112
Adjustment to initially apply the measurement date provisions of FAS 158, net of income tax benefit of \$317				572	(1,161)		(589)
Comprehensive income:							
Net income				1,375,548			1,375,548
Other comprehensive income, net of income tax:							
Unrealized losses on securities, net of income tax benefit of \$61,993					(269,022)		(269,022)
Defined benefit pension plans, net of income tax benefit of \$701					(4,032)		(4,032)
Foreign currency translation adjustments					(253,790)		(253,790)
Unrealized gains in cash flow hedging instruments, net of income tax of \$6,774					11,077		11,077
Other comprehensive income (loss)					(515,767)		(515,767)
Comprehensive income							859,781
Cash dividends - \$0.375 per share				(421,518)			(421,518)
Purchase of treasury stock						(12,025)	(12,025)

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(In Thousands, Except Per Share Data)	Common Stock		Paid-In Capital, Net	Retained Earnings	Cumulative Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
	Shares	Amount					
Issuances of common stock and restricted stock, net of forfeitures	17,170,062	172	758,602				758,774
Exercise of stock options and tax benefits of exercises and restricted stock vesting	1,910,252	19	60,699				60,718
Compensation expense for restricted stock awards and stock options			67,576				67,576
Allocation of ESOP shares			4,711				4,711
Balance, September 30, 2008	438,305,214	\$ 4,383	\$ 16,752,078	\$ 12,222,170	\$ (201,680)	\$ (3,165,411)	\$ 25,611,540

See Notes to Consolidated Financial Statements.

Table of Contents**CAPITAL ONE FINANCIAL CORPORATION****Consolidated Statements of Cash Flows****(Dollars in thousands) (unaudited)**

	Nine Months Ended September 30,	
	2008	2007
Operating Activities:		
Income from continuing operations, net of tax	\$ 1,480,842	\$ 2,270,107
Loss from discontinued operations, net of tax	(105,294)	(926,343)
Net Income	1,375,548	1,343,764
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan and lease losses	3,002,119	1,342,292
Depreciation and amortization, net	536,436	482,595
Gains on sales of securities available for sale	(13,713)	(68,306)
Gains on sales of auto loans	(2,428)	(10,927)
Gains on extinguishment of debt		(17,444)
Gains on repurchase of senior notes	(53,860)	
Mortgage loans held for sale:		
Transfers and originations	(1,639,636)	729,458
(Gain) loss on sales	(26,062)	7,712
Proceeds from sales	1,864,311	4,905,876
Stock plan compensation expense	74,381	309,969
Changes in assets and liabilities:		
Decrease in interest receivable	88,600	32,234
Increase in accounts receivable from securitizations	(262,944)	(2,318,418)
Increase in other assets	(960,113)	(1,378,508)
Decrease in interest payable	(123,518)	(22,429)
Increase in other liabilities	85,499	838,475
Net cash provided by operating activities attributable to discontinued operations	129,659	2,196,050
Net cash provided by operating activities	4,074,279	8,372,393
Investing Activities:		
Purchases of securities available for sale	(15,266,177)	(10,880,031)
Proceeds from maturities of securities available for sale	5,189,006	5,258,692
Proceeds from sales of securities available for sale	2,504,289	965,185
Proceeds from securitizations of loans	8,446,956	9,875,362
Net increase in loans held for investment	(7,649,922)	(8,921,503)
Principal recoveries of loans previously charged off	501,970	469,392
Additions of premises and equipment, net	(270,064)	(314,063)
Net payments for companies acquired		(10,464)
Net cash provided by investing activities attributable to discontinued operations	11,659	
Net cash used in investing activities	(6,532,283)	(3,557,430)
Financing Activities:		
Net increase (decrease) in deposits	16,151,798	(2,428,078)
Net increase (decrease) in other borrowings	(10,834,872)	515,093
Issuance of senior notes		1,495,740
Maturities of senior notes	(1,318,694)	(462,500)

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Repurchases of senior notes	(1,120,724)	
Purchases of treasury stock	(12,025)	(2,252,665)
Dividends paid	(421,518)	(31,885)
Net proceeds from issuances of common stock	763,485	32,777
Proceeds from share based payment activities	67,576	133,499
Net cash used in financing activities attributable to discontinued operations	(17,690)	(2,031,779)
Net cash provided by (used in) financing activities	3,257,336	(5,029,798)
Net increase (decrease) in cash and cash equivalents	799,332	(214,835)
Cash and cash equivalents at beginning of year	4,821,409	4,660,496
Cash and cash equivalents at end of period	\$ 5,620,741	\$ 4,445,661

See Notes to Consolidated Financial Statements.

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CAPITAL ONE FINANCIAL CORPORATION

Notes to Consolidated Financial Statements

(in thousands, except per share data) (unaudited)

Note 1

Significant Accounting Policies

Business

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.

During the first half of 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 called Capital One Bank (USA), National Association. 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.

In the third quarter of 2007, the Corporation 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 Note 2 Discontinued Operations.

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

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

The Consolidated Financial Statements include the accounts of Capital One Financial Corporation and its majority owned subsidiaries. Investments in unconsolidated entities where the Company has the ability to exercise significant influence over the operations of the investee are accounted for using the equity method of accounting. This includes interests in variable interest entities (VIEs) where the Company is not the primary beneficiary. Investments not meeting the criteria for equity method accounting are accounted for using the cost method of accounting. Investments in unconsolidated entities are included in other assets, and the Company's share of income or loss is recorded in other non-interest income. All significant intercompany balances and transactions have been eliminated. Certain prior years' amounts have been reclassified to

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conform to the 2008 presentation. All amounts in the following notes, excluding per share data, are presented in thousands.

The notes to the audited consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2007 should be read in conjunction with these consolidated financial statements.

Special Purpose Entities and Variable Interest Entities

Special purpose entities are broadly defined as legal entities structured for a particular purpose. The Company uses special purpose entities primarily to conduct off-balance sheet securitization activities. Special purpose entities that meet the criteria for Qualifying Special Purpose Entities (QSPE) as defined in Statement of Financial Accounting Standard No. 140, *Accounting for Transfers and*

Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140), are not required to be consolidated. Special purpose entities that are not QSPEs are considered for consolidation in accordance with Financial Accounting Standards Board Interpretation No. 46 (Revised 2003), *Consolidation of Variable Interest Entities (FIN 46R)*.

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In April 2008, The Financial Accounting Standards Board (FASB) voted to eliminate Qualifying Special Purpose Entities (QSPEs) from the guidance. On September 15, 2008, the FASB issued exposure drafts to amend SFAS 140 and FIN46R. The two proposed Statements would significantly change accounting for transfers of financial 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 September 30, 2008, the total assets of QSPEs to which the Company has transferred and received sales treatment were \$49.4 billion.

In general, a VIE is a special purpose entity formed as a corporation, partnership, limited liability corporation, or any other legal structure used to conduct activities or hold assets. A VIE often holds financial assets, including loans or receivables, real estate or other property.

The Company consolidates a VIE if the Company is considered to be its primary beneficiary. The primary beneficiary is subject to absorbing the majority of the expected losses from the VIE's activities, is entitled to receive a majority of the entity's residual returns, or both.

Derivative Instruments and Hedging Activities

The Company recognizes all of its derivative instruments as either assets or liabilities in the balance sheet at fair value. These instruments are recorded in other assets or other liabilities on the Consolidated Balance Sheet and in the operating section of the Statement of Cash Flows as increases (decreases) of other assets and other liabilities. The Company's policy is not to offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from derivative instruments recognized at fair value executed with the same counterparty under master netting arrangements. As of September 30, 2008 the Company had recorded \$331.9 million for the right to reclaim cash collateral and \$90.7 million for the obligation to return cash collateral under master netting arrangements.

Recent Accounting Pronouncements

Effective January 1, 2008, the Company adopted 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. Under FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2), the Company elected to defer the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities measured on a nonrecurring basis. SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. The initial adoption of SFAS 157 did not have a material impact on the consolidated earnings and financial position of the Company. There are no material assets or liabilities recognized or disclosed at fair value for which the Company has not applied the provisions of SFAS 157. See Note 7 for additional detail.

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. See Note 7 for additional detail.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133*, (SFAS 161). This Statement changes the disclosure requirements for derivative and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2008. The adoption of SFAS 161 will not have an impact on the consolidated earnings or financial position of the Company because it only amends the disclosure requirements for derivatives and hedged items.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51*, (SFAS 160). This Statement applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. This Statement amends ARB 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. This Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of SFAS 160 is not expected to have a material impact on the consolidated earnings or financial position of the Company.

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In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)), which applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. This Statement replaces SFAS 141, *Business Combinations*. It retains the fundamental requirements in SFAS 141; however, the scope is broader than that of SFAS 141 by applying to all transactions and other events in which one entity obtains control over one or more other businesses. SFAS 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, at their fair values as of that date, with limited exceptions, thereby replacing SFAS 141's cost-allocation process. This Statement also changes the requirements for recognizing acquisition related costs, restructuring costs, and assets acquired and liabilities assumed arising from contingencies. It also changes the accounting for step acquisitions. The Company will apply the provisions of SFAS 141(R) when applicable.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No 87, 88, 106, and 132(R)*, (SFAS 158). SFAS 158 requires plan sponsors of defined benefit pension and other postretirement benefit plans (collectively, defined benefit plans) to recognize the funded status of their defined benefit plans in the consolidated balance sheet, measure the fair value of plan assets and benefit obligations as of the date of the fiscal year-end consolidated balance sheet, and provide additional disclosures. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158. On January 1, 2008 the Company adopted SFAS 158's provisions regarding the change in the measurement date of defined benefit plans. The adoption of SFAS 158 did not have a material impact on the consolidated earnings or financial position of the Company.

Note 2**Discontinued Operations****Shutdown of Mortgage Origination Operations of Wholesale Mortgage Banking Unit**

In the third quarter of 2007, the Company shut down the mortgage origination operations of its wholesale mortgage banking unit, GreenPoint. GreenPoint was acquired by the Company in December 2006 as part of the North Fork acquisition. The results of the mortgage origination operations of GreenPoint have been accounted for as a discontinued operation and have been removed from the Company's results from continuing operations for the three and nine months ended September 30, 2008 and 2007.

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 include the mortgage servicing results for the three and nine months ended September 30, 2008 and 2007. The commercial and consumer mortgage loans held for investment portfolios were reported in the Local Banking segment and the Other category, respectively, for the three and nine months ended September 30, 2008 and 2007.

The Company retained \$1.6 billion of certain GreenPoint loans and reclassified them from mortgage loans held for sale to held for investment during 2007. Continuing cash flows from the held for investment loan portfolios are included in the Company's results of continuing operations for the three and nine months ended September 30, 2008 and 2007, and classified as operating cash flows in the statement of cash flows. The Company will have no significant continuing involvement in the operations of the originate and sell business of GreenPoint.

The loss from discontinued operations for the nine months ended September 30, 2008 includes an expense of \$83.0 million, recorded in non-interest expense, for representations and warranties provided by the Company on loans previously sold to third parties by GreenPoint's mortgage origination operation.

The following is summarized financial information for discontinued operations related to the closure of the Company's wholesale mortgage banking unit:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Net interest income ^{(1) (2)}	\$ 1,612	\$ (53,208)	\$ 5,332	\$ (17,714)
Non-interest income	2,287	16,810	5,517	139,868
Non-interest expense	22,125	1,013,020	175,577	1,215,281
Income tax benefit	(6,576)	(151,389)	(59,434)	(166,784)

Loss from discontinued operations, net of taxes	\$ (11,650)	\$ (898,029)	\$ (105,294)	\$ (926,343)
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- (1) Net interest income includes funding (credits)/charges of \$(7.2) million and \$10.9 million for the three months ended September 30, 2008 and 2007, and \$(22.1) million and \$48.8 million for the nine months ended September 30, 2008 and 2007, respectively, based on funds transfer pricing methodology.
- (2) Net interest income also includes provision for loan and lease losses of \$75.8 million and \$80.2 million for the three and nine months ended September 30, 2007. There is no provision for loan and lease losses for 2008 because loans were reclassified to loans held for sale and recorded at the lower of cost or market.

The Company's wholesale mortgage banking unit had assets of approximately \$20.2 million as of September 30, 2008 consisting of \$17.4 million of mortgage loans held for sale and other related assets. The related liabilities consisted of obligations to fund these assets, and obligations for representations and warranties provided by the Company on loans previously sold to third parties.

Note 3

Segments

The segments reflect the manner in which financial information is currently evaluated. The Company strategically manages and reports the results of its business through two operating segment levels: Local Banking and National Lending. The Local Banking segment 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 and home loans origination activities.

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 business and international lending businesses. The results of the GreenPoint mortgage origination operations are being reported as discontinued operations for 2008 and 2007, and are not included in the segment results of the Company. The results of GreenPoint's mortgage servicing business and small ticket commercial real estate loans held for investment portfolio are reported as part of the Company's continuing operations and included in the Local Banking segment. The results of GreenPoint's consumer mortgage held for investment portfolio are reported as part of the Company's continuing operations and included in the Other category.

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*, and are disclosed separately. The Other category includes the Company's liquidity portfolio, emerging businesses not included in the reportable segments, and various non-lending activities. The Other category also includes the results of GreenPoint's consumer mortgage held for investment portfolio, the net impact of transfer pricing, certain unallocated expenses, gains/losses related to the securitization of assets, and restructuring charges related to the Company's cost initiative announced in the second quarter of 2007.

The Company maintains its books and records on a legal entity basis for the preparation of financial statements in conformity with GAAP. The following tables present information prepared from the Company's internal management information system, which is maintained on a line of business level through allocations from the consolidated financial results.

See Note 1, Significant Accounting Policies in the Annual Report on Form 10-K for the accounting policies of the reportable segments.

The following tables present certain information regarding the Company's continuing operations by segment:

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Three Months Ended September 30, 2008

Total Company	National Lending	Local Banking	Other	Total Managed	Securitization Adjustments (1)	Total Reported
Net interest income	\$ 2,231,535	\$ 623,736	\$ 34,059	\$ 2,889,330	\$ (1,082,685)	\$ 1,806,645
Non-interest income	1,195,622	215,701	(85,764)	1,325,559	371,332	1,696,891
Provision for loan and lease losses	1,678,513	81,052	45,705	1,805,270	(711,353)	1,093,917
Restructuring expenses			15,306	15,306		15,306
Other non-interest expenses	1,176,396	622,697	(4,193)	1,794,900		1,794,900
Income tax provision (benefit)	200,626	47,491	(34,493)	213,624		213,624
Net income (loss)	\$ 371,622	\$ 88,197	\$ (74,030)	\$ 385,789	\$	\$ 385,789

Table of Contents**Three Months Ended September 30, 2008**

Total Company	National Lending	Local Banking	Other	Total Managed	Securitization Adjustments (1)	Total Reported
Loans held for investment	\$ 101,922,850	\$ 44,662,818	\$ 760,078	\$ 147,345,746	\$ (49,380,395)	\$ 97,965,351
Total deposits	\$ 1,650,507	\$ 75,045,812	\$ 22,216,655	\$ 98,912,974	\$	\$ 98,912,974

Three Months Ended September 30, 2007

Total Company	National Lending	Local Banking	Other	Total Managed	Securitization Adjustments (2)	Total Reported
Net interest income	\$ 2,275,739	\$ 586,304	\$ (58,605)	\$ 2,803,438	\$ (1,178,964)	\$ 1,624,474
Non-interest income	1,274,688	232,662	10,639	1,517,989	631,673	2,149,662
Provision for loan and lease losses	1,195,995	(58,192)	5,022	1,142,825	(547,291)	595,534
Restructuring expenses			19,354	19,354		19,354
Other non-interest expenses	1,333,688	577,309	3,870	1,914,867		1,914,867
Income tax provision (benefit)	350,277	104,353	(26,620)	428,010		428,010
Net income (loss)	\$ 670,467	\$ 195,496	\$ (49,592)	\$ 816,371	\$	\$ 816,371
Loans held for investment	\$ 102,556,271	\$ 42,233,665	\$ (21,375)	\$ 144,768,561	\$ (50,980,054)	\$ 93,788,507
Total deposits	\$ 2,295,131	\$ 72,795,566	\$ 8,034,332	\$ 83,125,029	\$	\$ 83,125,029

Three Months Ended September 30, 2008**Other National Lending components**

National Lending	U.S. Card	Other National Lending	Auto Finance	International	Total National Lending
Net interest income	\$ 1,616,038	\$ 615,497	\$ 369,501	\$ 245,996	\$ 2,231,535
Non-interest income	1,027,918	167,704	14,607	153,097	1,195,622
Provision for loan and lease losses	1,240,580	437,933	244,078	193,855	1,678,513
Non-interest expenses	872,588	303,808	117,677	186,131	1,176,396
Income tax provision	185,775	14,851	7,824	7,027	200,626
Net income	\$ 345,013	\$ 26,609	\$ 14,529	\$ 12,080	\$ 371,622
Loans held for investment	\$ 69,361,743	\$ 32,561,107	\$ 22,306,394	\$ 10,254,713	\$ 101,922,850

Three Months Ended September 30, 2007**Other National Lending components**

National Lending	U.S. Card	Other National Lending	Auto Finance	International	Total National Lending
Net interest income	\$ 1,620,397	\$ 655,342	\$ 377,522	\$ 277,820	\$ 2,275,739
Non-interest income	1,107,801	166,887	13,514	153,373	1,274,688
Provision for loan and lease losses	807,318	388,677	244,537	144,140	1,195,995
Non-interest expenses	965,351	368,337	152,275	216,062	1,333,688
Income tax provision (benefit)	328,702	21,575	(1,987)	23,562	350,277
Net income (loss)	\$ 626,827	\$ 43,640	\$ (3,789)	\$ 47,429	\$ 670,467
Loans held for investment	\$ 66,687,232	\$ 35,869,039	\$ 24,335,242	\$ 11,533,797	\$ 102,556,271

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- (1) Income statement adjustments for the three months ended September 30, 2008 reclassify the net of finance charges of \$1,369.0 million, past due fees of \$240.8 million, other interest income of \$(35.3) million and interest expense of \$491.8 million; and net charge-offs of \$711.4 million to non-interest income from net interest income and provision for loan and lease losses, respectively.
- (2) Income statement adjustments for the three months ended September 30, 2007 reclassify the net of finance charges of \$1,659.5 million, past due fees of \$262.7 million, other interest income of \$(42.7) million and interest expense of \$700.5 million; and net charge-offs of \$547.3 million to non-interest income from net interest income and provision for loan and lease losses, respectively.

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Nine Months Ended September 30, 2008

	National Lending	Local Banking	Other	Total Managed	Securitization Adjustments (1)	Total Reported
Total Company						
Net interest income	\$ 6,807,647	\$ 1,780,395	\$ 66,133	\$ 8,654,175	\$ (3,307,857)	\$ 5,346,318
Non-interest income	3,586,546	623,928	23,744	4,234,218	1,141,467	5,375,685
Provision for loan and lease losses	4,826,375	233,489	108,645	5,168,509	(2,166,390)	3,002,119
Restructuring expenses			81,625	81,625		81,625
Other non-interest expenses	3,692,134	1,815,259	(136,934)	5,370,459		5,370,459
Income tax provision	654,325	124,451	8,182	786,958		786,958
Net income	\$ 1,221,359	\$ 231,124	\$ 28,359	\$ 1,480,842	\$	\$ 1,480,842
Loans held for investment	\$ 101,922,850	\$ 44,662,818	\$ 760,078	\$ 147,345,746	\$ (49,380,395)	\$ 97,965,351
Total deposits	\$ 1,650,507	\$ 75,045,812	\$ 22,216,655	\$ 98,912,974	\$	\$ 98,912,974

Nine Months Ended September 30, 2007

	National Lending	Local Banking	Other	Total Managed	Securitization Adjustments (2)	Total Reported
Total Company						
Net interest income	\$ 6,402,810	\$ 1,751,516	\$ (135,089)	\$ 8,019,237	\$ (3,251,639)	\$ 4,767,598
Non-interest income	3,500,072	733,636	(34,172)	4,199,536	1,696,347	5,895,883
Provision for loan and lease losses	2,914,360	(10,487)	(6,289)	2,897,584	(1,555,292)	1,342,292
Restructuring expenses			110,428	110,428		110,428
Other non-interest expenses	4,058,495	1,744,012	29,868	5,832,375		5,832,375
Income tax provision (benefit)	1,008,079	262,136	(161,936)	1,108,279		1,108,279
Net income (loss)	\$ 1,921,948	\$ 489,491	\$ (141,332)	\$ 2,270,107	\$	\$ 2,270,107
Loans held for investment	\$ 102,556,271	\$ 42,233,665	\$ (21,375)	\$ 144,768,561	\$ (50,980,054)	\$ 93,788,507
Total deposits	\$ 2,295,131	\$ 72,795,566	\$ 8,034,332	\$ 83,125,029	\$	\$ 83,125,029

Nine Months Ended September 30, 2008

Other National Lending components

		Other National Lending	Auto Finance	International	Total National Lending
National Lending					
Net interest income	\$ 4,883,381	\$ 1,924,266	\$ 1,160,651	\$ 763,615	\$ 6,807,647
Non-interest income	3,108,926	477,620	46,389	431,231	3,586,546
Provision for loan and lease losses	3,460,058	1,366,317	882,943	483,374	4,826,375
Non-interest expenses	2,722,067	970,067	376,867	593,200	3,692,134
Income tax provision (benefit)	633,563	20,762	(18,469)	39,231	654,325
Net income (loss)	\$ 1,176,619	\$ 44,740	\$ (34,301)	\$ 79,041	\$ 1,221,359
Loans held for investment	\$ 69,361,743	\$ 32,561,107	\$ 22,306,394	\$ 10,254,713	\$ 101,922,850

Nine Months Ended September 30, 2007

Other National Lending components

		Other National Lending	Auto Finance	International	Total National Lending
National Lending					
Net interest income	\$ 4,503,975	\$ 1,898,835	\$ 1,123,613	\$ 775,222	\$ 6,402,810
Non-interest income	2,972,363	527,709	97,373	430,336	3,500,072

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Provision for loan and lease losses	1,837,748	1,076,612	626,873	449,739	2,914,360
Non-interest expenses	2,958,456	1,100,039	474,267	625,772	4,058,495
Income tax provision	921,966	86,113	41,227	44,886	1,008,079
Net income	\$ 1,758,168	\$ 163,780	\$ 78,619	\$ 85,161	\$ 1,921,948
Loans held for investment	\$ 66,687,232	\$ 35,869,039	\$ 24,335,242	\$ 11,533,797	\$ 102,556,271

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- (1) Income statement adjustments for the nine months ended September 30, 2008 reclassify the net of finance charges of \$4,278.3 million, past due fees of \$733.5 million, other interest income of \$(208.1) million and interest expense of \$1,594.1 million; and net charge-offs of \$2,166.4 million to non-interest income from net interest income and provision for loan and lease losses, respectively.
- (2) Income statement adjustments for the nine months ended September 30, 2007 reclassify the net of finance charges of \$4,686.1 million, past due fees of \$703.0 million, other interest income of \$(120.6) million and interest expense of \$2,016.9 million; and net charge-offs of \$1,555.3 million to non-interest income from net interest income and provision for loan and lease losses, respectively.

Significant Segment Transactions

During the second quarter of 2008, the Company recognized a gain of \$44.9 million in non-interest income from the conversion and sale of 154,991 shares of MasterCard class B common stock, which was recorded in the Other segment.

During the first quarter of 2008, the Company recognized a gain of \$109.0 million in non-interest income from the redemption of 2.5 million shares related to the Visa IPO. In addition, the Company reversed \$90.9 million in legal reserves in connection with the IPO and recorded the release in other non-interest expense. Both items were recorded in the Other segment.

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 and reported in the Other segment. The Company initiated the repurchases to take advantage of the current market environment and replaced the repurchased debt with lower-rate unsecured funding.

During the second quarter of 2007, the Company recognized a \$17.4 million gain as a component of interest expense from the early extinguishment of Trust Preferred Securities, which was recorded in the Other segment.

During the second quarter of 2007, the Company incurred a charge of \$39.8 million as a result of the accelerated vesting of equity awards made in connection with the transition of the management team for Local Banking business following the acquisition of North Fork, which was recorded in the Local Banking segment.

During the first quarter of 2007, the Company sold its remaining interest in DealerTrack, a leading provider of on-demand software and data solutions for the automotive retail industry. The sale resulted in a \$46.2 million gain, which was recorded in non-interest income and reported in the Auto Finance component.

Note 4**Earnings Per Share**

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Numerator:				
Income from continuing operations, net of tax	\$ 385,789	\$ 816,371	\$ 1,480,842	\$ 2,270,107
Loss from discontinued operations, net of tax	(11,650)	(898,029)	(105,294)	(926,343)
Net income (loss)	\$ 374,139	\$ (81,658)	\$ 1,375,548	\$ 1,343,764
Denominator:				
Denominator for basic earnings per share Weighted-average shares	372,928	386,133	372,010	395,199
Effect of dilutive securities:				
Stock options	328	3,772	491	5,088
Contingently issuable shares				255
Restricted stock and stock units	1,037	939	909	710

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Dilutive potential common shares	1,365	4,711	1,400	6,053
Denominator for diluted earnings per share Adjusted weighted-average shares	374,293	390,844	373,410	401,252
Basic earnings per share				
Income from continuing operations	\$ 1.03	\$ 2.11	\$ 3.98	\$ 5.74
Loss from discontinued operations	(0.03)	(2.32)	(0.28)	(2.34)
Net income (loss)	\$ 1.00	\$ (0.21)	\$ 3.70	\$ 3.40
Diluted earnings per share				
Income from continuing operations	\$ 1.03	\$ 2.09	\$ 3.96	\$ 5.66
Loss from discontinued operations	(0.03)	(2.30)	(0.28)	(2.31)
Net income (loss)	\$ 1.00	\$ (0.21)	\$ 3.68	\$ 3.35

Table of Contents**Note 5****Comprehensive Income**

Comprehensive income for the three months ended September 30, 2008 and 2007, respectively was as follows:

	Three Months Ended September 30	
	2008	2007
Comprehensive Income:		
Net income (loss)	\$ 374,139	\$ (81,658)
Other comprehensive income (loss), net of tax	(328,283)	100,753
Total comprehensive income	\$ 45,856	\$ 19,095

Note 6**Goodwill and Other Intangible Assets**

The following table provides a summary of goodwill.

Total Company	National Lending	Local Banking	Other	Total
Balance at December 31, 2007	\$ 6,235,700	\$ 6,595,040	\$	\$ 12,830,740
Impact of reporting structure reorganization	(87,848)	87,848		
Adjustments		(1,100)		(1,100)
Foreign currency translation	(13,998)			(13,998)
Balance at September 30, 2008	\$ 6,133,854	\$ 6,681,788	\$	\$ 12,815,642

National Lending Detail	Other National Lending components						National Lending Total
	U.S. Card	Global Financial Services	Other National Lending	Auto Finance	International		
Balance at December 31, 2007	\$ 3,005,180	\$ 1,800,132	\$ 1,430,388	\$ 1,430,388	\$	\$	\$ 6,235,700
Impact of reporting structure reorganization	756,138	(1,800,132)	956,146		956,146		(87,848)
Foreign currency translation			(13,998)		(13,998)		(13,998)
Balance at September 30, 2008	\$ 3,761,318	\$	\$ 2,372,536	\$ 1,430,388	\$ 942,148	\$	\$ 6,133,854

In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, the Company tests goodwill for impairment at least annually at the reporting unit level, which is an operating segment or one level below. For the three and nine months ended September 30, 2008, no impairment of goodwill was recognized. As a result of the Company's reorganization of its National Lending sub-segments in the first quarter of 2008, goodwill was reassigned to affected reporting units using a relative fair value allocation approach. See Note 3 for additional detail regarding the reorganization.

In connection with the acquisitions of Hibernia and North Fork, the Company recorded intangible assets that consisted of core deposit intangibles, trust intangibles, lease intangibles, and other intangibles, which are subject to amortization. The core deposit and trust intangibles reflect the estimated value of deposit and trust relationships. The lease intangibles reflect the difference between the contractual obligation under

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current lease contracts and the fair market value of the lease contracts at the acquisition date. The other intangible items relate to customer lists and brokerage relationships. The following table summarizes the Company's purchase accounting intangible assets subject to amortization.

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	September 30, 2008			Remaining Amortization Period
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
Core deposit intangibles	\$ 1,320,000	\$ (451,210)	\$ 868,790	9.3 years
Lease intangibles	14,247	(7,503)	6,744	22.2 years
Trust intangibles	10,500	(3,083)	7,417	15.2 years
Other intangibles	7,948	(3,606)	4,342	10.4 years
Total	\$ 1,352,695	\$ (465,402)	\$ 887,293	

Intangibles are amortized on an accelerated basis over their respective estimated useful lives. Intangible assets are recorded in other assets on the balance sheet. Amortization expense related to purchase accounting intangibles totaled \$48.5 million and \$149.5 million for the three and nine months ended September 30, 2008, respectively. Amortization expense for intangibles is recorded to non-interest expense. The weighted average amortization period for all purchase accounting intangibles is 9.5 years.

Note 7**Fair Values of Assets and Liabilities**

Effective January 1, 2008, the Company adopted SFAS 157, which provides a framework for measuring fair value under GAAP. 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 requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. 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 certain U.S. Treasury and other U.S. government agency mortgage-backed debt securities that are traded by dealers or brokers in active markets.

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 that use 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 option pricing models, discounted cash flow models and similar techniques.

The Company also adopted SFAS 159 on January 1, 2008. SFAS 159 allows an entity the irrevocable option to elect fair value for the initial and subsequent measurement for certain financial assets and liabilities on a contract-by-contract basis. SFAS 159 requires that the difference between the carrying value before election of the fair value option and the fair value of these instruments be recorded as an adjustment to beginning retained earnings in the period of adoption. The initial adoption of SFAS 159 did not have a material effect on the consolidated earnings and financial position of the Company.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

	September 30, 2008			Assets/Liabilities at Fair Value
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	

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Assets				
Securities available for sale	\$ 277,618	\$ 24,163,764	\$ 2,528,089	\$ 26,969,471
Other assets				
Mortgage servicing rights			227,101	227,101
Derivative receivables ⁽¹⁾	750	552,524	30,293	583,567
Retained interests in securitizations			1,679,618	1,679,618
Total Assets	\$ 278,368	\$ 24,716,288	\$ 4,465,101	\$ 29,459,757
Liabilities				
Other liabilities				
Derivative payables ⁽¹⁾	\$ 1,758	\$ 540,080	\$ 30,768	\$ 572,606

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	September 30, 2008			
	Fair Value Measurements Using			Assets/Liabilities at Fair Value
	Level 1	Level 2	Level 3	
Total Liabilities	\$ 1,758	\$ 540,080	\$ 30,768	\$ 572,606

(1) The Company does not offset the fair value of derivative contracts in a loss position against the fair value of contracts in a gain position. The Company also does not offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement.

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during 2008. All Level 3 instruments presented in the table were carried at fair value prior to the adoption of SFAS 159.

Level 3 Instruments Only

	Three Months Ended September 30, 2008				
	Securities Available for Sale	Mortgage Servicing Rights ⁽¹⁾	Derivative Receivables ⁽²⁾	Retained Interests in Securitized ⁽³⁾	Derivative Payables ⁽²⁾
Balance, June 30, 2008	\$ 2,695,143	\$ 232,423	\$ 9,884	\$ 1,293,544	\$ 9,683
Total realized and unrealized gains (losses):					
Included in earnings	18	(726)	2,537	(72,356)	2,543
Included in other comprehensive income	(226,412)			970	
Purchases, issuances and settlements	6,866	(4,596)	17,872	457,460	18,542
Transfers into Level 3 ⁽⁴⁾	52,474				
Balance, September 30, 2008	\$ 2,528,089	\$ 227,101	\$ 30,293	\$ 1,679,618	\$ 30,768
Change in unrealized gains (losses) included in earnings related to financial instruments held at September 30, 2008	\$	\$ (726)	\$ 2,537	\$ 42,324	\$ 2,543

	Nine Months ended September 30, 2008				
	Securities Available for Sale	Mortgage Servicing Rights ⁽¹⁾	Derivative Receivables ⁽²⁾	Retained Interests in Securitized ⁽³⁾	Derivative Payables ⁽²⁾
Balance, January 1, 2008	\$ 217,428	\$ 247,589	\$ 8,962	\$ 1,295,498	\$ 8,631
Total realized and unrealized gains (losses):					
Included in earnings	18	(1,704)	2,911	5,957	2,931
Included in other comprehensive income	(241,843)			(10,612)	
Purchases, issuances and settlements	183,249	(18,784)	18,420	388,775	19,206
Transfers into Level 3 ⁽⁴⁾	2,369,237				
Balance, September 30, 2008	\$ 2,528,089	\$ 227,101	\$ 30,293	\$ 1,679,618	\$ 30,768
Change in unrealized gains (losses) included in earnings related to financial instruments held at September 30, 2008	\$	\$ (1,704)	\$ 2,911	\$ 32,611	\$ 2,931

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- (1) Gains (losses) related to Level 3 mortgage servicing rights are reported in mortgage servicing and other income, which is a component of non-interest income.
- (2) An end of quarter convention is used to measure derivative activity, resulting in end of quarter values being reflected as purchases, issuances and settlements for derivatives having a zero fair value at inception. Gains (losses) related to Level 3 derivative receivables and derivative payables are reported in other non-interest income, which is a component of non-interest income.
- (3) An end of quarter convention is used to reflect activity in retained interests in securitizations, resulting in all transactions and assumption changes being reflected as if they occurred on the last day of the quarter. Gains (losses) related to Level 3 retained interests in securitizations are reported in servicing and securitizations income, which is a component of non-interest income.

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- (4) Level 3 assets increased \$52.5 million and \$2.4 billion for the three and nine months ended September 30, 2008, respectively, due primarily to the reclassification of AAA rated non-agency mortgage backed securities backed by prime jumbo collateral. The ongoing capital markets dislocation has decreased new issuance and secondary trading volumes for many fixed income markets. This lower level of activity makes it increasingly difficult to find consistent pricing of many fixed income securities. The pricing of our prime jumbo non-agency mortgage-backed securities continued to exhibit a variation that was outside of our Level 2 assets policy tolerances. Consequently, we reassigned additional securities to Level 3.

The amount of Level 3 securities will likely continue to be a function of market conditions. An increase in dislocation and corresponding decrease in new issuance and trading volumes could result in the reclassification of additional securities to Level 3. If market conditions improve and pricing transparency and consistency increase, assets currently classified as Level 3 could be reclassified to Level 2.

Level 3 Valuation Techniques

Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. A brief description of the valuation techniques used for Level 3 assets and liabilities is provided below.

Securities available for sale

Certain securities available for sale are classified as Level 3, the majority of which are non-agency mortgage-backed securities backed by prime collateral. Classification of Level 3 indicates that significant valuation assumptions are not consistently observable in the market. When significant assumptions are not consistently observable, fair values are derived using the best available data. Such data may include quotes provided by a dealer, the use of external pricing services, independent pricing models, or other model-based valuation techniques such as calculation of the present values of future cash flows incorporating assumptions such as benchmark yields, spreads, prepayment speeds, credit ratings, and losses.

Mortgage servicing rights

Mortgage servicing rights (MSRs) do not trade in an active market with readily observable prices. Accordingly, the Company determines the fair value of MSRs using a valuation model that calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment spreads, discount rate, cost to service, contractual servicing fee income, ancillary income and late fees. Since the adoption of SFAS 156 in 2007, the Company records MSRs at fair value on a recurring basis. Fair value measurements of MSRs use significant unobservable inputs and, accordingly, are classified as Level 3. The valuation technique for these securities is discussed in more detail in Note 8 Mortgage Servicing Rights.

Derivatives

Most of the Company's derivatives are not exchange traded but instead traded in over the counter markets where quoted market prices are not readily available. The fair value of those derivatives is derived using models that use primarily market observable inputs, such as interest rate yield curves, credit curves, option volatility and currency rates. Any derivative fair value measurements using significant assumptions that are unobservable are classified as Level 3, which include interest rate swaps whose remaining terms extend beyond market observable interest rate yield curves. The impact of Capital One's non performance risk is considered when measuring the fair value of derivative liabilities.

Retained interests in securitizations

Retained interests in securitizations include the interest-only strip, retained notes, cash reserve accounts and cash spread accounts. The Company uses a valuation model that calculates the present value of estimated future cash flows. The model incorporates the Company's own estimates of assumptions market participants use in determining fair value, including estimates of payment rates, defaults, discount rates, and contractual interest and fees.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company is also required to measure certain other financial assets at fair value on a nonrecurring basis in accordance with GAAP. The following table provides the level of valuation assumptions used to determine each adjustment and the carrying value of the related assets for assets measured at fair value on a nonrecurring basis during 2008 that were still held on the balance sheet at September 30, 2008.

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	September 30, 2008				Total Losses
	Fair Value Measurements Using			Assets at	
	Level 1	Level 2	Level 3	Fair Value	
Assets					
Mortgage loans held for sale	\$	\$ 17,432	\$ 13,131	\$ 30,563	\$ 17,561
Loans held for investment		50,298	138,684	188,982	35,819
Total	\$	\$ 67,730	\$ 151,815	\$ 219,545	\$ 53,380

Mortgage loans held for sale

Mortgage loans held for sale are carried at the lower of aggregate cost, net of deferred fees, deferred origination costs and effects of hedge accounting, or fair value. The fair value of mortgage loans held for sale is determined using current secondary market prices for portfolios with similar characteristics. As such, the Company classifies these loans subject to nonrecurring fair value adjustments as Level 2.

Loans held for investment

Commercial and small business loans are considered impaired in accordance with the provisions of Statement of Financial Accounting Standard No. 114, *Accounting by Creditors for Impairment of a Loan*, (SFAS 114) when it is probable that all amounts due in accordance with the contractual terms will not be collected. From time to time, the Company records nonrecurring fair value adjustments to reflect the fair value of the loans collateral.

Note 8**Mortgage Servicing Rights**

Mortgage servicing rights (MSR), are recognized when mortgage loans are sold in the secondary market and the right to service these loans is retained for a fee. MSRs are carried at fair value with changes in fair value recognized in mortgage servicing and other, a component of non-interest income. The Company enters into interest rate swaps to economically hedge changes in fair value of MSRs. The Company continues to operate the mortgage servicing business and reports the changes in the fair value of MSRs and the related interest rate swaps in continuing operations. To evaluate and measure fair value of MSRs, the underlying loans are stratified based on certain risk characteristics, including loan type, note rate and investor servicing requirements. The following table sets forth the changes in the fair value of mortgage servicing rights during the three and nine months ended September 30, 2008 and 2007:

Mortgage Servicing Rights:	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Balance, beginning of period	\$ 232,423	\$ 316,031	\$ 247,589	\$ 252,295
Cumulative effect adjustment for the adoption of FAS 156				15,187
Originations		18,342		64,503
Sales		(961)	(273)	(2,676)
Change in fair value	(5,322)	(34,133)	(20,215)	(30,030)
Balance, end of period	\$ 227,101	\$ 299,279	\$ 227,101	\$ 299,279
Ratio of mortgage servicing rights to related loans serviced for others	0.90%	1.00%	0.90%	1.00%
Weighted average service fee	0.28	0.28	0.28	0.28

Fair value adjustments to the MSRs for the three and nine months ended September 30, 2008, included a \$4.6 million decrease and a \$18.5 million decrease due to run-off, respectively, and a \$0.7 million decrease and a \$1.7 million decrease due to changes in the valuation inputs and assumptions, respectively.

The significant assumptions used in estimating the fair value of the servicing assets at September 30, 2008 were as follows:

	September 30, 2008	September 30, 2007
Weighted average prepayment rate (includes default rate)	22.61%	23.91%
Weighted average life (in years)	4.5	4.0
Discount rate	11.07%	10.47%

At September 30, 2008, the sensitivities to immediate 10% and 20% increases in the weighted average prepayment rates would decrease the fair value of mortgage servicing rights by \$10.0 million and \$19.0 million, respectively.

As of September 30, 2008, the Company's mortgage loan servicing portfolio consisted of mortgage loans with an aggregate unpaid principal balance of \$36.4 billion, of which \$25.4 billion was serviced for investors other than the Company.

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The Company recognizes changes in the fair value of the interest rate swaps in other non-interest income. For the three and nine months ended September 30, 2008, the Company recognized income of \$9.9 million and \$20.7 million, respectively.

Note 9**Borrowings**

Borrowings as of September 30, 2008 and December 31, 2007 were as follows:

	September 30, 2008		December 31, 2007	
	Outstanding	Weighted Average Rate	Outstanding	Weighted Average Rate
Interest-bearing deposits	\$ 88,247,688	3.08%	\$ 71,714,627	3.67%
Senior and subordinated notes				
Bank notes fixed rate Corporation	\$ 2,351,795	5.69%	\$ 3,525,699	5.49%
	5,927,061	4.89%	7,187,007	5.75%
Total	\$ 8,278,856		\$ 10,712,706	
Other borrowings				
Secured borrowings	\$ 8,648,589	5.25%	\$ 13,067,562	4.60%
Junior subordinated debentures	1,647,320	7.78%	1,645,656	7.39%
FHLB advances	4,884,523	3.69%	6,841,789	4.63%
Federal funds purchased and resale agreements	781,345	2.16%	683,186	3.19%
Other short-term borrowings	295	7.41%	4,574,776	5.88%
Total	\$ 15,962,072		\$ 26,812,969	

Interest-Bearing Deposits

As of September 30, 2008, the Company had \$88.2 billion in interest-bearing deposits of which \$10.3 billion represents large denomination certificates of \$100 thousand or more. As of December 31, 2007, the Company had \$71.7 billion in interest-bearing deposits of which \$10.0 billion represents large denomination certificates of \$100 thousand or more. The increase of \$16.5 billion is driven by increases in NOW and money market deposit accounts and other time deposits, which include brokered deposits.

Other Borrowings**Secured Borrowings**

COAF maintained eighteen agreements to transfer pools of consumer loans accounted for as secured borrowings at September 30, 2008. The agreements were entered into between 2004 and 2007, relating to the transfers of pools of consumer loans totaling \$27.5 billion. Principal payments on the borrowings are based on principal collections, net of losses, on the transferred consumer loans. The secured borrowings accrue interest predominantly at fixed rates and mature between October 2008 and September 2011, or earlier depending upon the repayment of the underlying consumer loans. At September 30, 2008 and December 31, 2007, \$8.6 billion and \$13.1 billion, respectively, of the secured borrowings were outstanding. The decrease of \$4.5 billion is primarily due to normal amortization of the secured borrowings.

FHLB Advances

Total advances with FHLB agencies as of September 30, 2008 were \$4.9 billion. 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. In addition, the Company's

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FHLB membership is secured by the Company's investment in FHLB stock, which totaled \$267.3 million at September 30, 2008 and is included in other assets.

Other Short-Term Borrowings

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 September 30, 2008, the Capital One Auto Loan Facility I had the capacity to issue up to \$1.3 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.

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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 September 30, 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.

Note 10

Commitments, Contingencies and Guarantees

Letters of Credit and Financial Guarantees

The Company issues letters of credit (financial standby, performance standby and commercial) to meet the financing needs of its customers. Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party in a borrowing arrangement. Commercial letters of credit are short-term commitments issued primarily to facilitate trade finance activities for customers and are generally collateralized by the goods being shipped to the client. Collateral requirements are similar to those for funded transactions and are established based on management's credit assessment of the customer. Management conducts regular reviews of all outstanding letters of credit and customer acceptances, and the results of these reviews are considered in assessing the adequacy of the Company's allowance for loan and lease losses.

The Company had contractual amounts of standby letters of credit and commercial letters of credit of \$1.3 billion and \$1.2 billion at September 30, 2008 and 2007, respectively. As of September 30, 2008, financial guarantees had expiration dates ranging from 2008 to 2015. The fair value of the liability related to the standby letters of credit outstanding at September 30, 2008 that have been issued since January 1, 2003 was \$3.6 million and included in other liabilities.

The Company's discontinued wholesale mortgage banking unit, GreenPoint, previously sold home equity lines of credit in whole loan sales and subsequently acquired a residual interest in certain third party securitizations involving some of those loans. As residual interest holder, GreenPoint is required to fund advances on the home equity lines of credit when certain performance triggers are met due to deterioration in asset performance. GreenPoint's ability to recover the full amount advanced to customers is dependent on monthly collections on the loans. In certain limited circumstances, such future advances could be reduced if GreenPoint suspends the right of mortgagors to receive draws or reduces the credit limit on home equity lines of credit.

There are eight securitization transactions where GreenPoint is a residual interest holder with the longest draw period currently extending through 2023. GreenPoint has funded \$15.2 million of advances through September 30, 2008 related to these transactions. The Company believes it is probable that a loss has been incurred on several of these transactions due to the deterioration in asset performance through September 30, 2008. However, the Company cannot estimate the possible loss or range of loss at this time. The maximum potential amount of future advances related to all third-party securitizations where GreenPoint is the residual interest holder is \$239.2 million, an amount which represents the total loan amount on the home equity lines of credit within those eight securitizations. The total unutilized amount as of September 30, 2008 is \$80.6 million.

Securitization Guarantees

In connection with certain installment loan securitization transactions, the transferee (off-balance sheet special purpose entity receiving the installment loans) entered into interest rate hedge agreements (the swaps) with a counterparty to reduce interest rate risk associated with the transactions. In connection with the swaps, the Company entered into letter agreements guaranteeing the performance of the transferee under the swaps. If at anytime the Class A invested amount equals zero and the notional amount of the swap is greater than zero resulting in an Early Termination Date (as defined in the securitization transaction's master agreement), then (a) to the extent that, in connection with the occurrence of such Early Termination Date, the transferee is obligated to make any payments to the counterparty pursuant to the master agreement, the Company shall reimburse the transferee for the full amount of such payment and (b) to the extent that, in connection with the occurrence of an Early Termination Date, the transferee is entitled to receive any payment from the counterparty pursuant to the master agreement, the transferee will pay to the Company the amount of such payment. At September 30, 2008, the maximum exposure to the Company under the letter agreements was approximately \$7.1 million.

Industry Litigation

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In accordance with the provisions of SFAS No. 5, Accounting for Contingencies, (SFAS 5), the Company accrues for a litigation related liability when it is probable that such a liability has been incurred and the amount of the loss can be reasonably estimated. In addition, the Company is a Class B shareholder of Visa, Inc. (Visa) as a result of Visa's initial public offering (IPO) completed earlier in 2008. The Company has indemnification obligations to Visa with respect to final judgments and settlements of certain

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litigation against Visa pending at the time of the IPO (the *Visa Covered Litigation*). Visa established a litigation escrow (the *Visa Litigation Escrow*) with proceeds from the IPO to fund Covered Litigation. The Company accounts for its indemnification obligations to Visa in accordance with the provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees*, (FIN 45). The Company has no on-going litigation indemnification obligation to MasterCard International (*MasterCard*) following the MasterCard initial public offering in 2006.

Over the past several years, MasterCard and Visa as well as several of their member banks have been involved in several different lawsuits challenging various practices of MasterCard and Visa.

In 2004, Discover Financial Services (*Discover*) filed an antitrust lawsuit (the *Discover Lawsuit*) against MasterCard and Visa alleging, among other things, that exclusionary agreements in the MasterCard and Visa association rules prevented their member banks from issuing Discover cards. The Company and its subsidiaries are not defendants in the Discover Lawsuit, but the lawsuit qualifies as *Visa Covered Litigation*. On October 27, 2008, Visa announced that a settlement agreement had been reached. The settlement did not have a material impact on the Company's operations or financial condition.

In 2005, a number of entities, each purporting to represent a class of retail merchants, filed antitrust lawsuits (the *Interchange lawsuits*) against MasterCard and Visa, representing the last of the remaining significant *Visa Covered Litigation*. The antitrust lawsuits were also filed against several member banks, including the Company and its subsidiaries (the *Class Lawsuits*). Separately, a number of large merchants have asserted similar claims against Visa and MasterCard only (the *Merchant Lawsuits*). These lawsuits allege, among other things, that the defendants conspired to fix the level of interchange fees. The complaints seek injunctive relief and civil monetary damages, which could be trebled. In October 2005, the Class Lawsuits and the Merchant Lawsuits were consolidated before the United States District Court for the Eastern District of New York for certain purposes, including discovery. Discovery is proceeding in these cases. The Company believes it has meritorious defenses and intends to defend these cases vigorously. Given the complexity of the issues raised by these lawsuits and the uncertainty regarding: (i) the outcome of these suits, (ii) the likelihood and amount of any possible judgments, (iii) the likelihood, amount and validity of any claim against the member banks, including the Company and its subsidiary banks, (iv) changes in industry structure that may result from the suits and (v) the effects of these suits, in turn, on competition in the industry, member banks, and interchange fees, the Company cannot determine at this time the long-term effects of these lawsuits.

In 2007, a number of individual plaintiffs, each purporting to represent a class of cardholders, filed antitrust lawsuits in the United States District Court for the Northern District of California against several issuing banks, including the Company (the *In Re Late Fees Litigation*). These lawsuits allege, among other things, that the defendants conspired to fix the level of late fees and over-limit fees charged to cardholders, and that these fees are excessive. In May 2007, the cases were consolidated for all purposes and a consolidated amended complaint was filed alleging violations of federal statutes and state law. The amended complaint requests civil monetary damages, which could be trebled. In November 2007, the court dismissed the amended complaint. Plaintiffs have appealed that order.

Other Pending and Threatened Litigation

In addition, the Company is commonly subject to various pending and threatened legal actions relating to the conduct of its normal business activities. In the opinion of management, the ultimate aggregate liability, if any, arising out of any such pending or threatened legal actions will not be material to its consolidated financial position or its results of operations.

Tax issues for years 1995-1999 are pending in the U.S. Tax Court. The ultimate resolution of these issues is not expected to have a material effect upon the Company's operations or financial condition.

Note 11

Restructuring

Restructuring initiatives leverage the capabilities of recently completed infrastructure projects in several of the Company's businesses. The scope and timing of the expected cost reductions are the result of an ongoing, comprehensive review of operations within and across the Company's businesses, which began in the second quarter of 2007.

The Company anticipates recording charges of approximately \$300.0 million pre-tax over the course of the cost reduction initiative through 2008. Approximately \$150.0 million of these charges are related to severance benefits, while the remaining charges are associated with items such as contract and lease terminations and consolidation of facilities and infrastructure. These costs are recognized in Other Segments.

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Restructuring expenses associated with continuing operations were comprised of the following:

	Three months ended September 30, 2008	Nine months ended September 30, 2008
Restructuring expenses:		
Employee termination benefits	\$ 5,812	\$ 58,284
Communication and data processing	772	828
Supplies and equipment	445	1,397
Occupancy		3,280
Other	8,277	17,836
Total restructuring expenses	\$ 15,306	\$ 81,625

Employee termination benefits include charges for executives of the Company for the three and nine months ended September 30, 2008 of \$3.2 million and \$15.6 million, respectively, and charges for associates of the Company for the three and nine months ended September 30, 2008 of \$2.6 million and \$42.7 million, respectively.

The Company made \$27.0 million and \$71.5 million in cash payments for restructuring charges during the three and nine months ended September 30, 2008 that related to employee termination benefits. Restructuring accrual activity associated with the Company's cost initiative for the three and nine months ended September 30, 2008 was as follows:

	Three months ended September 30, 2008	Nine months ended September 30, 2008
Restructuring accrual activity:		
Balance, beginning of period	\$ 84,983	\$ 67,961
Restructuring charges	15,306	81,625
Cash payments	(27,031)	(71,521)
Noncash write-downs and other adjustments	(3,016)	(7,823)
 Balance, end of period	 \$ 70,242	 \$ 70,242

Note 12**Subsequent Events**

On October 27, 2008, the Company announced its intention to take part in the U.S. Treasury's Capital Purchase Program (CPP). Under the CPP the U.S. Treasury will purchase \$3.55 billion of Capital One preferred stock, which pay dividends of 5% per year for the first five years and 9% thereafter. The Company can buy back these shares at any time, under certain circumstances. The CPP's terms, which are consistent across the program, include, among other things, a requirement to receive the U.S. Treasury's consent to increase dividends on common stock and the U.S. Treasury's consent to repurchase common stock or junior preferred shares. The U.S. Treasury's term sheet describing the CPP is available on its website at www.ustreas.gov. In addition, the U.S. Treasury will receive a ten year right to purchase approximately \$532.5 million in Capital One common stock, based on the market price of our common stock, calculated on a 20-trading day trailing average, on the date the transaction closes.

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Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations* **(Dollars in thousands) (yields and rates presented on an annualized basis)**

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.

During the first half of 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 called Capital One Bank (USA), National Association. 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.

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

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 losses, operating expenses (including associate salaries and benefits, infrastructure maintenance and enhancements, and branch operations and expansion costs), marketing expenses, and income taxes.

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 business and international lending businesses.

II. Critical Accounting Estimates

See our Annual Report on Form 10-K for the year ended December 31, 2007, Part I, Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations* for a summary of our critical accounting estimates.

Fair Value Measurements

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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. Under FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2), the Company elected to defer the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities measured on a nonrecurring basis. SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. The initial adoption of SFAS 157 did not have a material impact on the consolidated earnings and financial position of the Company. There are no material assets or liabilities recognized or disclosed at fair value for which the Company has not applied the provisions of SFAS 157.

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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.

Additional information is included in this Quarterly Report under the heading *Notes to Consolidated Financial Statements* Note 1 *Summary of Significant Accounting Policies* and Note 7 *Fair Value of Assets and Liabilities*.

III. Off-Balance Sheet Arrangements

See our Annual Report on Form 10-K for the year ended December 31, 2007, Part III, Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations* for a summary of the Company's off-balance sheet arrangements.

Of the Company's total managed loans, 34% and 35% were included in off-balance sheet securitizations for the periods ended September 30, 2008 and September 30, 2007, respectively.

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*. On September 15, 2008, the FASB issued exposure drafts to amend SFAS 140 and FIN46R. The two proposed Statements would significantly change accounting for transfers of financial 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 September 30, 2008, the total assets of QSPEs to which the Company has transferred and received sales treatment were \$49.4 billion.

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 three months ended September 30, 2008

(Dollars in thousands)	Total Reported	Securitization Adjustments ⁽¹⁾	Total Managed ⁽²⁾
Income Statement Measures⁽³⁾			
Net interest income	\$ 1,806,645	\$ 1,082,685	\$ 2,889,330
Non-interest income	1,696,891	(371,332)	1,325,559
Total revenue	3,503,536	711,353	4,214,889
Provision for loan and lease losses	1,093,917	711,353	1,805,270
Net charge-offs	\$ 872,077	\$ 711,353	\$ 1,583,430
Balance Sheet Measures			
Loans held for investment	\$ 97,965,351	\$ 49,380,395	\$ 147,345,746
Total assets	154,803,113	48,668,878	203,471,991

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Average loans held for investment	98,778,393	48,469,005	147,247,398
Average earning assets	133,314,755	46,475,814	179,790,569
Average total assets	156,997,954	47,735,935	204,733,889
Delinquencies	\$ 3,768,339	\$ 2,106,140	\$ 5,874,479

- (1) Income statement adjustments for the three months ended September 30, 2008 reclassify the net of finance charges of \$1,369.0 million, past due fees of \$240.8 million, other interest income of \$(35.3) million and interest expense of \$491.8 million; and net charge-offs of \$711.4 million to non-interest income from net interest income and provision for loan and lease losses, respectively.

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- (2) The managed loan portfolio does not include mortgage loans or 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

Discontinued Operations

In the third quarter of 2007, the Company shut down the mortgage origination operations of its wholesale mortgage banking unit, GreenPoint. GreenPoint was acquired by the Company in December 2006 as part of the North Fork Bancorporation acquisition. The results of the mortgage origination operations of GreenPoint have been accounted for as discontinued operations and, accordingly, separately disclosed from the Company's results of continuing operations for 2008 and 2007. Additional information is included in this Quarterly Report under the heading Notes to the Consolidated Financial Statements Note 2 Discontinued Operations.

Continuing Operations

The following discussion provides a summary of the third quarter of 2008 results compared to the same period in the prior year. All comparisons are based on continuing operations unless otherwise noted.

Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007

Net income was \$374.1 million, or \$1.00 per share (diluted) for the three months ended September 30, 2008, compared to the net loss of \$81.7 million, or \$0.21 per share (diluted) for the three months ended September 30, 2007. Net income in the third quarter 2008 included an after-tax loss from discontinued operations of \$11.7 million, or \$0.03 per share (diluted), compared to an after-tax loss from discontinued operations of \$898.0 million, or \$2.32 per share (diluted) in the third quarter of 2007.

Income from continuing operations for the third quarter 2008 was \$385.8 million, a decrease of \$430.6 million, or 53% from \$816.4 million in the third quarter 2007. Diluted earnings per share from continuing operations for the third quarter of 2008 were \$1.03, a decrease of 51% from \$2.09 in the third quarter 2007.

Results from continuing operations for the three months ended September 30, 2008 include:

An increase of \$264.8 million in the provision for loan and lease losses from June 30, 2008 due to an increase in the expected losses as a result of the continued weakness in the global economy and associated deterioration in credit, resulting in an increase in our coverage ratio of allowance to loans held for investment.

A \$66.7 million write down in the Company's interest-only strip recorded in non-interest income.

Q3 2008 Significant Events

Weakening Global Economy and Credit Deterioration

The continuing weakness in the global economy and associated credit deterioration has impacted the Company in multiple ways during the quarter, including:

Increased managed charge-off rate and managed delinquency rate to 4.30% and 3.99% from 4.15% and 3.64% in the second quarter 2008, respectively,

Increased the allowance for loan and leases losses by \$208.6 million to \$3.5 billion,

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Continued to tighten underwriting resulting in modest growth in our managed loans held for investment of \$147.3 billion, an increase of \$99.0 million from the second quarter 2008.

Our revenue margin, risk-adjusted margin and net interest margin recovered modestly to 9.38%, 5.86% and 6.43%, from 9.12%, 5.70% and 6.22% in the second quarter 2008, respectively. The changes in our margins from the second quarter 2008 were due to the following factors:

an increase in early stage delinquencies compared to the second quarter 2008, which increases past due fees recorded in interest income,

seasonal impacts resulting in growth in our U.S. Card portfolio, which drove higher interest income,

a decrease in our average cost of funds during the third quarter 2008 from 3.42% to 3.35%, and

the \$66.7 million write-down in the interest-only strip during the third quarter, which suppressed our margins.

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Secondary Equity Offering

On September 30, 2008, the Company raised approximately \$750 million through the issuance of 15,527,000 shares of common stock at \$49 per share.

Subsequent Event

U.S. Treasury Department's Capital Purchase Program Participation

On October 27, 2008, the Company announced its intention to take part in the U.S. Treasury's Capital Purchase Program (CPP). Under the CPP the U.S. Treasury will purchase \$3.55 billion of Capital One preferred stock, which pay dividends of 5% per year for the first five years and 9% thereafter. The Company can buy back these shares at any time, under certain circumstances. The CPP's terms, which are consistent across the program, include, among other things, a requirement to receive the U.S. Treasury's consent to increase dividends on common stock and the U.S. Treasury's consent to repurchase common stock or junior preferred shares. The U.S. Treasury's term sheet describing the CPP is available on its website at www.ustreas.gov. In addition, the U.S. Treasury will receive a ten year right to purchase approximately \$532.5 million in Capital One common stock, based on the market price of our common stock, calculated on a 20-trading day trailing average, on the date the transaction closes.

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 our 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.

Business Outlook

The statements contained in this section are based on our current expectations regarding the Corporation's 2008 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 of this Form 10-Q and the Corporation's Annual Report on Form 10-K for the year ended December 31, 2007.

2008 Expectations

Like many banks, Capital One expects to face continuing challenges due to the state of the global economy. Expectations for 2008 financial and business results include:

Low single-digit percentage reduction in year-end volume of managed loan balances;

Double digit percentage growth in year-end deposit balances;

Low single digit percentage revenue growth, consistent with low single-digit growth in average loans;

The efficiency ratio for the 4th quarter of 2008 is expected to increase as a result of seasonal increases in operating expenses. However, the Corporation continues to expect that full-year efficiency ratio will finish in the mid-40% range or lower.

Operating expenses for 2008 will be around \$6.2 billion, a reduction of approximately \$400 million from 2007 operating expenses

Increased delinquency and charge-off rates;

A tangible common equity (TCE) ratio above 6 percent; and

Quarterly dividends of \$0.375 per share throughout 2008.

Operating Segments

In the Local Banking segment, the Corporation expects flat loan growth for the remainder of 2008, as an expected decrease in residential mortgages and small ticket commercial real estate loans continues to offset expected growth in commercial loans. The Corporation expects double-digit percentage deposit growth across the Corporation, with continued single-digit deposit growth in the Local Banking segment due to increased product and marketing efforts in its branch and direct banking channels.

In the National Lending businesses, the Corporation expects several factors, including weakening consumer credit and uncertainty regarding the broader economy, to negatively impact financial results through 2008 and into 2009.

In the U.S. Card sub-segment, the Corporation expects the competitive environment to remain challenging, despite the continued degradation seen in the broader economy.

The Corporation expects the U.S. Card managed charge-off rate for fourth quarter 2008 to be around 7%, and to increase to the mid-7% range in the first quarter of 2009 due to typical seasonal patterns, continued weakening economic indicators as experienced in the first three quarters of 2008, the abatement of stimulus checks, and the initial impacts of adopting OCC minimum payment rules as noted below.

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The Corporation expects to maintain a cautious approach to its underwriting and marketing practices. In 2008, the Corporation expects slightly higher year-end loan balances in U.S. Card, driven by expected seasonal balance growth, continuing payment rate trends, and fewer balance transfers away from the Corporation. The Corporation also expects to continue to implement process and efficiency improvements.

In the Auto Finance sub-segment, the Corporation expects to continue to face challenges from the seasoning of loans originated in 2006 and 2007 and from broader cyclical economic challenges. The Corporation expects that the combination of these factors will continue to impact the performance of the Auto Finance business through 2009.

The Corporation has reduced its automobile finance originations across the credit spectrum, particularly by originating loans to less risky customers within the subprime market in lieu of those the Corporation believes to be most risky, and by largely ceasing its originations of automobile loans to near prime consumers. The Auto Finance business is also focusing on a smaller network of dealers who have historically produced loans with better credit and profit performance.

Overall, the Corporation expects automobile financing loan originations to be at least 45% lower during 2008 than during 2007. As a result, the Company expects charge-offs and delinquencies arising from its automobile finance loans originated in 2008 to be lower than from those originated in 2007. The Corporation also expects its automobile finance charge-off and delinquency rates, as well as its operating expenses as a percentage of loans, to increase as outstanding automobile loan assets decrease. The Corporation will continue to monitor the performance of its Auto Finance business, especially the performance of new originations, and is prepared to take further actions based on future results and industry conditions over the next few quarters.

In the International businesses, the Corporation remains cautious about its U.K. credit card business due to degrading economic trends in the U.K. The Corporation expects continued stable performance in its Canadian credit card business.

OCC Minimum Payment Rules

In March 2008, COBNA converted from a Virginia state-chartered 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 will be 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 will have the effect of increasing the minimum payment for delinquent customers, while lowering it for many customers who are current.

The Company has been conducting a phased conversion of the U.S. Card portfolio to the OCC minimum payment policies with the full portfolio being converted by year end 2008. The Company has been analyzing the expected impacts on delinquencies and charge offs and believes that the implementation of this policy will cause delinquencies and roll rates to increase starting in early 2009. The Company expects the conversion to 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's analysis also indicates that the charge-off impacts will begin to cure somewhat in 2010 as customers adjust to the new minimum payment policies. These estimated impacts are included in the company's expected U.S. Card charge-off rates 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 losses, discussed in section VI, Summary of the Reported Income Statement, allowance for loan and lease losses.

VI. Financial Summary

Table 1 provides a summary view of the consolidated income statement and selected metrics for the Company as of and for the three and nine month periods ended September 30, 2008 and 2007.

Table 1: Financial Summary

(Dollars in thousands)	As of and for the Three Months Ended			As of and for the Nine Months Ended		
	2008	September 30 2007 ⁽³⁾	Change	2008	September 30 2007 ⁽³⁾	Change
Earnings (Reported):						

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Net interest income	\$ 1,806,645	\$ 1,624,474	\$ 182,171	\$ 5,346,318	4,767,598	578,720
Non-interest income:						
Servicing and securitizations	875,718	1,354,303	(478,585)	2,793,520	3,569,281	(775,761)
Service charges and other customer-related fees	576,762	522,374	54,388	1,675,032	1,484,820	190,212

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(Dollars in thousands)	As of and for the Three Months Ended			As of and for the Nine Months Ended		
	2008	September 30 2007 ⁽³⁾	Change	2008	September 30 2007 ⁽³⁾	Change
Mortgage servicing and other	39,183	52,661	(13,478)	90,990	172,476	(81,486)
Interchange	148,076	103,799	44,277	432,708	347,889	84,819
Other	57,152	116,525	(59,373)	383,435	321,417	62,018
Total non-interest income	1,696,891	2,149,662	(452,771)	5,375,685	5,895,883	(520,198)
Total Revenue ⁽¹⁾	3,503,536	3,774,136	(270,600)	10,722,003	10,663,481	58,522
Provision for loan and lease losses	1,093,917	595,534	498,383	3,002,119	1,342,292	1,659,827
Marketing	267,372	332,693	(65,321)	853,265	989,654	(136,389)
Restructuring expenses	15,306	19,354	(4,048)	81,625	110,428	(28,803)
Operating expenses	1,527,528	1,582,174	(54,646)	4,517,194	4,842,721	(325,527)
Income from continuing operations before taxes	599,413	1,244,381	(644,968)	2,267,800	3,378,386	(1,110,586)
Income taxes	213,624	428,010	(214,386)	786,958	1,108,279	(321,321)
Income from continuing operations, net of tax	385,789	816,371	(430,582)	1,480,842	2,270,107	(789,265)
Loss from discontinued operations, net of tax	(11,650)	(898,029)	886,379	(105,294)	(926,343)	821,049
Net income (loss)	374,139	(81,658)	455,797	1,375,548	1,343,764	31,784

Common Share Statistics:

Basic EPS:

Income from continuing operations, net of tax	\$	1.03	\$	2.11	\$	(1.08)	\$	3.98	\$	5.74	\$	(1.76)
Loss from discontinued operations, net of tax		(0.03)		(2.32)		2.29		(0.28)		(2.34)		2.06

Net income (loss)	\$	1.00	\$	(0.21)	\$	(1.21)	\$	3.70	\$	3.40	\$	0.30
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Diluted EPS:

Income from continuing operations, net of tax	\$	1.03	\$	2.09	\$	(1.06)	\$	3.96	\$	5.66	\$	(1.70)
Loss from discontinued operations, net of tax		(0.03)		(2.30)		2.27		(0.28)		(2.31)		2.03

Net income (loss)	\$	1.00	\$	(0.21)	\$	1.21	\$	3.68	\$	3.35	\$	0.33
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Selected Balance Sheet Data: ⁽²⁾

Reported loans held for investment (period end)	\$	97,965,351	\$	93,788,507	\$	4,176,844	\$	97,965,351	\$	93,788,507	\$	4,176,844
Managed loans held for investment (period end)		147,345,746		144,768,561		2,577,185		147,345,746		144,768,561		2,577,185
Reported loans held for investment (average)		98,778,393		91,744,846		7,033,547		98,848,686		92,111,953		6,736,733
Managed loans held for investment (average)		147,247,398		143,781,268		3,466,130		148,223,952		143,501,913		4,722,039
Allowance for loan and lease losses		(3,519,610)		(2,320,000)		(1,199,610)		(3,519,610)		(2,320,000)		(1,199,610)
Interest bearing deposits (period end)		88,247,688		72,284,840		15,962,848		88,247,688		72,284,840		15,962,848
Total deposits (period end)		98,912,974		83,125,029		15,787,945		98,912,974		83,125,029		15,787,945
Interest bearing deposits (average)		84,654,608		73,337,939		11,316,669		79,241,009		74,333,994		4,907,015

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Total deposits (average)	95,328,030	84,667,245	10,660,785	89,957,584	85,666,297	4,291,287
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Selected Company Metrics

(Reported): ⁽²⁾

Return on average assets (ROA)	0.98%	2.28%	(1.30)%	1.28%	2.12%	(0.84)%
Return on average equity (ROE)	6.16%	12.89%	(6.73)%	7.96%	11.94%	(3.98)%
Net charge-off rate	3.53%	2.09%	1.44%	3.28%	1.90%	1.38%
Delinquency rate (30+ days)	3.85%	3.22%	0.63%	3.85%	3.22%	0.63%
Net interest margin	5.42%	5.49%	(0.07)%	5.45%	5.32%	0.13%
Revenue margin	10.51%	12.83%	(2.32)%	10.92%	11.92%	(1.00)%
Risk adjusted margin ⁽⁴⁾	7.90%	11.13%	(3.23)%	8.44%	10.44%	(2.00)%

Selected Company Metrics

(Managed): ⁽²⁾

Return on average assets (ROA)	0.75%	1.68%	(0.93)%	0.97%	1.56%	(0.59)%
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(Dollars in thousands)	As of and for the Three Months Ended			As of and for the Nine Months Ended		
	2008	September 30 2007 ⁽³⁾	Change	2008	September 30 2007 ⁽³⁾	Change
Net charge-off rate	4.30%	2.86%	1.44%	4.14%	2.66%	1.48%
Delinquency rate (30+ days)	3.99%	3.48%	0.51%	3.99%	3.48%	0.51%
Efficiency ratio ⁽⁵⁾	42.58%	44.31%	(1.73)%	41.67%	47.73%	(6.06)%
Net interest margin	6.43%	6.67%	(0.24)%	6.47%	6.34%	0.13%
Revenue margin	9.38%	10.27%	(0.89)%	9.64%	9.67%	(0.03)%
Risk adjusted margin ⁽⁴⁾	5.86%	7.83%	(1.97)%	6.20%	7.92%	(1.72)%

- (1) In accordance with our finance charge and fee revenue recognition policy, the amounts billed to customers but not recognized as revenue were \$445.7 million and \$310.5 million for the three months ended September 30, 2008 and 2007, respectively, and \$1,329.3 and \$760.5 million for the nine months ended September 30, 2008 and 2007, respectively.
- (2) Based on continuing operations.
- (3) Certain prior period amounts have been reclassified to conform to current period presentation.
- (4) Risk adjusted margin equals total revenue less net charge-offs as a percentage of average earning assets.
- (5) Efficiency ratio equals non-interest expense less restructuring expense divided by total revenue.

Summary of the Reported Income Statement

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

All quarterly comparisons are made between the three month period ended September 30, 2008 and the three month period ended September 30, 2007 on a continuing operations basis, unless otherwise noted. All year to date comparisons are made between the nine month period ended September 30, 2008 and the nine month period ended September 30, 2007, 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 and past-due fees earned and deemed collectible from loans and income earned on securities, less interest expense on interest-bearing deposits, senior and subordinated notes and other borrowings.

For the three months ended September 30, 2008, reported net interest income increased 11.2%, or \$182.2 million. Net interest margin decreased 7 basis points to 5.42% for the three months ended September 30, 2008 from 5.49% for the three months ended September 30, 2007.

For the nine months ended September 30, 2008, reported net interest income increased 12.1%, or \$578.7 million. Net interest margin increased 13 basis points to 5.45% for the nine months ended September 30, 2008 from 5.32% for the nine months ended September 30, 2007.

The increases in net interest income were primarily driven by modest loan growth and increased margins in the U.S. Card sub-segment due to selective pricing changes implemented after the completion of the card holder system conversion in 2007.

For additional information, see section XII, Tabular Summary, Table A (Statements of Average Balances, Income and Expense, Yields and Rates) and Table B (Interest Variance Analysis).

Non-interest income

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

For the three months ended September 30, 2008, reported non-interest income decreased 21.1% compared to the three months ended September 30, 2007. The decrease was due to decreases in servicing and securitizations and a reduction in mortgage servicing and other.

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For the nine months ended September 30, 2008, reported non-interest income decreased 8.8% compared to the nine months ended September 30, 2007. The decrease was due to decreases in servicing and securitizations and a reduction in mortgage servicing and other.

See detailed discussion of the components of non-interest income below.

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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.

For the three months ended September 30, 2008, servicing and securitizations income decreased 35.3% to \$875.7 million from \$1.4 billion for the three months ended September 30, 2007.

For the nine months ended September 30, 2008, servicing and securitizations income decreased 21.7% to \$2.8 billion from \$3.6 billion for the nine months ended September 30, 2007.

The decrease was due to the reduction in the interest-only strip caused by higher expected charge-offs in the securitized portfolio as a result of the worsening credit environment.

Service Charges and Other Customer-Related Fees

For the three months ended September 30, 2008, service charges and other customer-related fees grew 10.4% to \$576.8 million from \$522.4 million in the third quarter of 2007.

For the nine months ended September 30, 2008, service charges and other customer-related fees grew 12.8% to \$1.7 billion from \$1.5 billion for the nine months ended September 30, 2007.

The increase was due to the U.S. Card sub-segment selective pricing and fee changes implemented late in the second and third quarters of 2007.

Mortgage Servicing and Other

Mortgage servicing and other is comprised of non-interest income related to our continuing mortgage servicing business and other mortgage related income. For the three months ended September 30, 2008, mortgage servicing and other income decreased 25.6% to \$39.2 million from \$52.7 million in the same period of 2007.

For the nine months ended September 30, 2008, mortgage servicing and other income decreased 47.2% to \$91.0 million from \$172.5 million in the same period of 2007.

The decrease was due to the changes in fair value of the mortgage servicing rights attributable to the run-off of the portfolio and the discontinuance of originations subsequent to the shutdown of GreenPoint's mortgage origination business in 2007.

Interchange

Interchange income increased \$44.3 million to \$148.1 million for the three months ended September 30, 2008 and increased \$84.8 million to \$432.7 million for the nine months ended September 30, 2008, due to an increase in purchase volume of 23.0% for the three months ended and 18.1% for the nine months ended, partially offset by higher costs associated with the rewards program.

Other Non-Interest Income

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

Other non-interest income for the three months ended September 30, 2008 decreased 51.0% or \$59.4 million to \$57.2 million and for the nine months ended September 30, 2008 increased 19.3% or \$62.0 million to \$383.4 million. The increase for the nine months ended September 30, 2008 is primarily the result of recognizing a gain of \$44.9 million from the conversion and sale of shares of MasterCard class B common stock in the second quarter of 2008, and the gains of \$109.0 million from the redemption of 2.5 million shares related to the Visa IPO and \$52.0 million from the repurchase of senior unsecured debt in the first quarter of 2008.

Provision for loan and lease losses

Provision for loan and lease losses increased \$498.4 million to \$1.1 billion for the three months ended September 30, 2008, compared to the same period in the prior year.

Provision for loan and lease losses increased \$1.7 billion to \$3.0 billion for the nine months ended September 30, 2008, compared to the same period in the prior year.

The increase in provision is a result of continued economic weakening and charge-off and delinquency trends.

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Non-interest expense

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

Non-interest expense decreased 6.4% to \$1.8 billion for the three months ended September 30, 2008. The decrease is due to decreased salary and associate benefit expenses of \$55.7 million and decreased marketing expenses of \$65.3 million.

Non-interest expense decreased 8.3% to \$5.5 billion for the nine months ended September 30, 2008. The decrease is due to decreased salary and associate benefit expenses of \$208.8 million and decreased marketing expenses of \$136.4 million.

Marketing expenses decreased as a result of changes in the mix of marketing channels and selected pullbacks across all segments. Operating expenses were also lower as a result of continued focus on efficiency gains.

Income taxes

The Company's effective income tax rate was 35.6% and 34.7% for the three month and nine month periods ended September 30, 2008, respectively, compared to 34.4% and 32.8% for the same periods in the prior year. The effective rate includes federal, state, and international tax components. The increase in the rate for the three and nine month periods ended September 30, 2008 was primarily due to decreases in certain tax credits and a \$69.0 million one-time tax benefit recognized in the second quarter of 2007 related to the Company's international tax position.

During the nine months ended September 30, 2008, the Company settled a number of federal and state tax examinations of acquired subsidiaries related to pre-acquisition tax periods. Those settlements resulted in a reduction in the amount of gross unrecognized tax benefits of approximately \$50.0 million.

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 grew 2.4%, or \$3.5 billion compared to the three months ended September 30, 2007. The increase was seen in both our National Lending segment and our Local Banking segment which had increases of \$337.2 million and \$2.3 billion, respectively.

Average managed loans held for investment grew 3.3%, or \$4.7 billion compared to the nine months ended September 30, 2007. The increase primarily consisted of an increase of \$1.7 billion in the National Lending segment and an increase of \$2.2 billion in the Local Banking segment.

For additional information, see the discussion of segment results in section VII, Reportable Segment Summary and see section XII, Tabular Summary, Table C (Managed Consumer Loan Portfolio) and Table D (Composition of Reported Loan Portfolio).

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 consumer loan portfolio for the third quarter of 2008 increased 63 and 51 basis points to 3.85% and 3.99%, respectively, compared to the same period in the prior year. The increases are attributed to the impact of selective pricing and fee policy changes late in the second quarter of 2007 and continued economic weakening.

For additional information, see section XII, Tabular Summary, Table E (Delinquencies).

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

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loans at 120 days past the due date or upon repossession of collateral. Bankruptcies charge-off within 30 days of notification and deceased customers' 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 collections expense in other non-interest expense.

The reported and managed net charge-off rates each increased 144 basis points, with net charge-off dollars increasing 82% and 54% on a reported and managed basis, respectively, for the three months ended September 30, 2008 compared to the same period in the prior year.

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The reported and managed net charge-off rates increased 138 and 148 basis points, respectively, with net charge-off dollars increasing 86% and 60% on a reported and managed basis, respectively, for the nine months ended September 30, 2008 compared to the same period in the prior year.

The increase in net charge-off rates is attributed to the impact of selective pricing and fee policy changes, which increased the underlying customer balances, and the continued economic weakening in the U.S.

For additional information, see section XII, Tabular Summary, Table F (Net Charge-offs).

Nonperforming Loans

Nonperforming loans include commercial loans, consumer real estate and auto loans that 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.

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.

Nonperforming loans as a percentage of total loans held for investment were 0.67% and 0.31% at September 30, 2008 and 2007, respectively.

For additional information, see section XII, Tabular Summary, Table G (Nonperforming Assets).

Allowance for loan and lease losses

The allowance for loan and lease losses related to loans held for investment increased \$1.2 billion, or 52% to \$3.5 billion at September 30, 2008 from \$2.3 billion at September 30, 2007. The increase is driven primarily by continued economic weakening and charge-off and delinquency trends in our National Lending businesses. The allowance for loan and lease losses of \$3.5 billion is consistent with an outlook of \$7.2 billion in managed charge-offs through the end of the third quarter of 2009.

For additional information, see section XII, Tabular Summary, Table H (Summary of Allowance for Loan and Lease Losses).

VII. Reportable Segment Summary

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.

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.

Local Banking Segment

Table 2: Local Banking

Three Months Ended September 30,	Nine Months Ended September 30,
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(Dollars in thousands)	2008	2007	2008	2007
Earnings (Managed Basis)				
Interest income	\$ 1,519,217	\$ 1,751,898	\$ 4,584,154	\$ 5,229,944
Interest expense	895,481	1,165,594	2,803,759	3,478,428
Net interest income	623,736	586,304	1,780,395	1,751,516
Non-interest income	215,701	232,662	623,928	733,636
Total revenue	839,437	818,966	2,404,323	2,485,152
Provision for loan and lease losses	81,052	(58,192)	233,489	(10,487)
Non-interest expense	622,697	577,309	1,815,259	1,744,012
Income before taxes	135,688	299,849	355,575	751,627

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(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Income taxes	47,491	104,353	124,451	262,136
Net income	\$ 88,197	\$ 195,496	\$ 231,124	\$ 489,491
Selected Metrics (Managed Basis)				
Commercial lending				
Commercial and multi-family real estate ⁽⁴⁾	\$ 13,043,369	\$ 11,961,400	\$ 13,043,369	\$ 11,961,400
Middle market ⁽⁵⁾	9,768,420	7,544,926	9,768,420	7,544,926
Small ticket commercial real estate ⁽⁶⁾	2,695,570	2,335,012	2,695,570	2,335,012
Specialty lending ⁽⁷⁾	3,634,212	3,019,100	3,634,212	3,019,100
Total commercial lending	29,141,571	24,860,438	29,141,571	24,860,438
Small business lending ⁽⁸⁾	4,580,299	4,612,400	4,580,299	4,612,400
Consumer lending				
Mortgages ⁽⁹⁾	7,402,290	8,902,468	7,402,290	8,902,468
Branch based home equity & other consumer ⁽¹⁰⁾	3,782,342	4,075,828	3,782,342	4,075,828
Total consumer lending	11,184,632	12,978,296	11,184,632	12,978,296
Other ⁽¹¹⁾	(243,684)	(217,469)	(243,684)	(217,469)
Period end loans held for investment	\$ 44,662,818	\$ 42,233,665	\$ 44,662,818	\$ 42,233,665
Average loans held for investment	\$ 44,319,475	\$ 41,992,618	\$ 44,153,047	\$ 41,983,812
Core deposits ⁽¹⁾	\$ 64,386,336	\$ 62,494,588	\$ 64,386,336	\$ 62,494,588
Total deposits	\$ 75,045,812	\$ 72,795,566	\$ 75,045,812	\$ 72,795,566
Loans held for investment yield	6.25%	7.13%	6.45%	7.05%
Net interest margin loans ⁽²⁾	1.98%	1.79%	1.97%	1.86%
Net interest margin deposits ⁽³⁾	2.18%	2.09%	2.05%	2.03%
Efficiency ratio	74.18%	70.49%	75.50%	70.18%
Charge-off rates				
Commercial lending				
Commercial and multi-family real estate	0.14%	0.00%	0.09%	0.02%
Middle market	0.15%	(0.04)%	0.12%	0.02%
Small ticket commercial real estate	0.10%	0.35%	0.13%	0.17%
Specialty lending	0.26%	0.14%	0.16%	0.09%
Total commercial lending	0.16%	0.04%	0.11%	0.04%
Small business lending	1.17%	0.47%	1.02%	0.41%
Consumer lending				
Mortgages	0.50%	0.08%	0.31%	0.09%
Branch based home equity & other consumer	1.01%	0.79%	1.08%	0.66%
Total consumer lending	0.67%	0.31%	0.57%	0.26%
Net charge-off rate	0.46%	0.20%	0.37%	0.18%
Non performing loans	\$ 430,211	\$ 112,794	\$ 430,211	\$ 112,794
Foreclosed assets	41,290	14,083	41,290	14,083
Non performing assets ⁽¹²⁾	\$ 471,501	\$ 126,877	\$ 471,501	\$ 126,877
Non performing loans as a % of loans held of investment	0.96%	0.27%	0.96%	0.27%
Non performing asset rates ⁽¹²⁾				
Commercial lending				
Commercial and multi-family real estate	1.06%	0.08%	1.06%	0.08%
Middle market	0.26%	0.29%	0.26%	0.29%

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Small ticket commercial real estate	4.49%	0.27%	4.49%	0.27%
Specialty lending	0.38%	0.19%	0.38%	0.19%
Total commercial lending	1.03%	0.17%	1.03%	0.17%
Small business lending	1.14%	0.93%	1.14%	0.93%
Consumer lending				
Mortgages	1.41%	0.35%	1.41%	0.35%
Branch based home equity & other consumer	0.40%	0.25%	0.40%	0.25%

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(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Total consumer lending	1.07%	0.32%	1.07%	0.32%
Total non performing asset rate	1.05%	0.30%	1.05%	0.30%
Non-interest expense as a % of average loans held for investment	5.62%	5.50%	5.48%	5.54%
Number of active ATMs	1,310	1,282	1,310	1,282
Number of locations	739	732	739	732

- (1) 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 income-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 multifamily 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 the 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 lending and certain branch originated consumer lending; and its mortgage servicing and home loans origination activities.

The Banking segment contributed \$88.2 million and \$231.1 million of income for the three and nine months ended September 30, 2008, respectively, compared to \$195.5 million and \$489.5 million in the comparable periods of the prior year. At September 30, 2008, loans held for investment in the Local Banking segment totaled \$44.7 billion while deposits outstanding totaled \$75.0 billion. 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. Net interest income increased 6.4% for the quarter ended September 30, 2008 compared to the prior year quarter and 1.7% compared to the nine months ended September 30, 2007 largely due to improved loan spreads and a slight increase in deposit margins, along with increases in average loans and deposits over the prior year periods.

Non-interest income declined for the three and nine months ended September 30, 2008 compared to the same periods of the prior year as mortgage originations decreased significantly over 2007 levels due to the continued industry-wide challenges in the mortgage market. The decline in mortgage originations resulted in lower gain on sale revenue for the nine months ended September 30, 2008 of \$49.3 million. In addition, the nine months ended September 30, 2008 included an increase in the representations and warranty reserves of \$14.0 million which is recorded as an offset to non-interest income. The nine months ended September 30, 2007 also included a one time gain of \$13.3 million from the sale of Hibernia Insurance Agency.

Provision for loan and lease losses increased for the three and nine months ended September 30, 2008 \$139.2 million and \$244.0 million, respectively, as additional loan loss provisions were recorded to reflect the increase in non-performing loans during the quarter. Credit quality of the segment's loan portfolio has been negatively impacted by the general economic weakening. However, losses remain at relatively low levels, with a net charge-off rate of 0.46% and 0.37% for the three and nine months ended September 30, 2008, respectively. In addition, the three months ended September 30, 2007 included a reduction in the allowance for loan losses of \$80.4 million to conform the allowance methodologies of the banking business.

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Non-interest expenses for the three and nine months ended September 30, 2008 were \$622.7 million and \$1.8 billion, respectively, compared to \$577.3 million and \$1.7 billion in the comparable periods of the prior year. Non-interest expenses include the direct costs of operating the branch network and commercial, small business and consumer loan businesses, marketing expenses, and certain

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Company-wide expenses allocated to the segment. In addition, non-interest expense includes the amortization of core deposit intangibles as well as the costs of integrating banking segment activities. During the nine months ended September 30, 2008 the Company completed the integration of its deposit systems and the conversion of its branch network in New York and New Jersey to the Capital One Bank brand. Non-interest expense increased due to integration related expenses and increases related to the full year operation of branches opened during 2007.

Table of Contents**National Lending Segment****Table 3: National Lending**

(Dollars in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Earnings (Managed Basis)				
Interest income	\$ 3,251,446	\$ 3,504,019	\$ 9,963,236	\$ 10,005,282
Interest expense	1,019,911	1,228,280	3,155,589	3,602,472
Net interest income	2,231,535	2,275,739	6,807,647	6,402,810
Non-interest income	1,195,622	1,274,688	3,586,546	3,500,072
Total revenue	3,427,157	3,550,427	10,394,193	9,902,882
Provision for loan and lease losses	1,678,513	1,195,995	4,826,375	2,914,360
Other non-interest expense	1,176,396	1,333,688	3,692,134	4,058,495
Income before taxes	572,248	1,020,744	1,875,684	2,930,027
Income taxes	200,626	350,277	654,325	1,008,079
Net income	\$ 371,622	\$ 670,467	\$ 1,221,359	\$ 1,921,948
Selected Metrics (Managed Basis)				
Period end loans held for investment	\$ 101,922,850	\$ 102,556,271	\$ 101,922,850	\$ 102,556,271
Average loans held for investment	\$ 102,142,752	\$ 101,805,584	\$ 103,243,404	\$ 101,532,376
Core deposits ⁽¹⁾	\$ 2,171	\$ 470	\$ 2,171	\$ 470
Total deposits	\$ 1,650,507	\$ 2,295,131	\$ 1,650,507	\$ 2,295,131
Loans held for investment yield	12.73%	13.77%	12.87%	13.14%
Net interest margin	8.74%	8.94%	8.79%	8.41%
Revenue margin	13.42%	13.95%	13.42%	13.00%
Risk-adjusted margin	7.57%	9.99%	7.80%	9.31%
Non-interest expense as a % of average loans held for investment	4.61%	5.24%	4.77%	5.33%
Efficiency ratio	34.33%	37.56%	35.52%	40.98%
Net charge-off rate	5.85%	3.96%	5.62%	3.69%
30+ day delinquency rate	5.43%	4.70%	5.43%	4.70%
Number of accounts (000s)	45,314	48,473	45,314	48,473

(1) 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.

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.

The National Lending segment contributed \$371.6 million of net income for the quarter ended September 30, 2008, compared to \$670.5 million in the prior year quarter. At September 30, 2008, loans outstanding in the National Lending segment totaled \$101.9 billion while deposits outstanding totaled \$1.7 billion. Profits are primarily generated from net interest income, including past-due fees earned and deemed collectible from our loans, and non-interest income including the sale and servicing of loans and other fees charged to customers. Total revenue decreased 3.5% from the prior year quarter, primarily due to the selective pricing changes in the U.S. Card sub-segment which increased revenues during the second half of 2007. Provision for loan and lease losses increased \$482.5 million, or 40.3% compared to the same quarter last year, driven by increased credit losses in the U.S. Card, International and Auto Finance businesses, and continued economic weakening.

Table of Contents**U.S. Card Sub-Segment****Table 4: U.S. Card**

(Dollars in thousands)	Three Months Ended		Nine Months Ended	
	September 30, 2008	September 30, 2007	September 30, 2008	September 30, 2007
Earnings (Managed Basis)				
Interest income	\$ 2,240,896	\$ 2,418,890	\$ 6,806,845	\$ 6,858,426
Interest expense	624,858	798,493	1,923,464	2,354,451
Net interest income	1,616,038	1,620,397	4,883,381	4,503,975
Non-interest income	1,027,918	1,107,801	3,108,926	2,972,363
Total revenue	2,643,956	2,728,198	7,992,307	7,476,338
Provision for loan and lease losses	1,240,580	807,318	3,460,058	1,837,748
Non-interest expense	872,588	965,351	2,722,067	2,958,456