

CAPITAL ONE FINANCIAL CORP  
Form 10-Q  
August 09, 2012  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from            to

Commission File No. 1-13300

**CAPITAL ONE FINANCIAL CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware  
(State or Other Jurisdiction of

54-1719854  
(I.R.S. Employer

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Incorporation or Organization)

Identification No.)

1680 Capital One Drive,

McLean, Virginia

22102

(Address of Principal Executive Offices)

(Zip Code)

Registrant's telephone number, including area code:

(703) 720-1000

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

(Not applicable)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

Indicate by check mark whether the registrant is a Shell Company (as defined in Rule 12b-2 of the Exchange Act) Yes  No

As of July 31, 2012, there were 580,850,895 shares of the registrant's Common Stock, par value \$.01 per share, outstanding.

**Table of Contents****TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I FINANCIAL INFORMATION</b>	<b>1</b>
Item 1. <u>Financial Statements</u>	64
<u>Condensed Consolidated Balance Sheets</u>	64
<u>Condensed Consolidated Statements of Income</u>	65
<u>Condensed Consolidated Statements of Comprehensive Income</u>	66
<u>Condensed Consolidated Statement of Changes in Stockholders' Equity</u>	67
<u>Condensed Consolidated Statements of Cash Flows</u>	68
<u>Notes to Condensed Consolidated Financial Statements</u>	69
<u>Note 1 Summary of Significant Accounting Policies</u>	69
<u>Note 2 Acquisitions</u>	71
<u>Note 3 Discontinued Operations</u>	76
<u>Note 4 Investment Securities</u>	77
<u>Note 5 Loans</u>	87
<u>Note 6 Allowance for Loan and Lease Losses</u>	108
<u>Note 7 Variable Interest Entities and Securitizations</u>	111
<u>Note 8 Goodwill and Other Intangible Assets</u>	120
<u>Note 9 Deposits and Borrowings</u>	123
<u>Note 10 Derivative Instruments and Hedging Activities</u>	126
<u>Note 11 Stockholders' Equity</u>	132
<u>Note 12 Earnings Per Common Share</u>	132
<u>Note 13 Fair Value of Financial Instruments</u>	133
<u>Note 14 Business Segments</u>	148
<u>Note 15 Commitments, Contingencies and Guarantees</u>	151
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&amp;A )</u>	1
<u>Summary of Selected Financial Data</u>	1
<u>Introduction</u>	5
<u>Executive Summary and Business Outlook</u>	6
<u>Critical Accounting Policies and Estimates</u>	10
<u>Consolidated Results of Operations</u>	11
<u>Business Segment Financial Performance</u>	18
<u>Consolidated Balance Sheet Analysis and Credit Performance</u>	31
<u>Off-Balance Sheet Arrangements and Variable Interest Entities</u>	35
<u>Capital Management</u>	35
<u>Risk Management</u>	38
<u>Credit Risk Profile</u>	39
<u>Liquidity Risk Profile</u>	52
<u>Market Risk Profile</u>	55
<u>Supervision and Regulation</u>	58
<u>Accounting Changes and Developments</u>	59
<u>Forward-Looking Statements</u>	59
<u>Supplemental Tables</u>	62
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	163
Item 4. <u>Controls and Procedures</u>	163
<b>PART II OTHER INFORMATION</b>	<b>164</b>
Item 1. <u>Legal Proceedings</u>	164
Item 1A. <u>Risk factors</u>	164
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	164
Item 3. <u>Defaults upon Senior Securities</u>	164
Item 5. <u>Other Information</u>	164
Item 6. <u>Exhibits</u>	164
<b>SIGNATURES</b>	<b>165</b>
<b>EXHIBIT INDEX</b>	<b>166</b>



**Table of Contents****INDEX OF MD&A TABLES AND SUPPLEMENTAL TABLES**

<b>Table</b>	<b>Description</b>	<b>Page</b>
	<b>MD&amp;A Tables:</b>	
1	<u>Consolidated Financial Highlights (Unaudited)</u>	2
2	<u>Business Segment Results</u>	6
3	<u>Average Balances, Net Interest Income and Net Interest Yield</u>	12
4	<u>Rate/Volume Analysis of Net Interest Income</u>	14
5	<u>Non-Interest Income</u>	15
6	<u>Non-Interest Expense</u>	17
7	<u>Credit Card Business Results</u>	20
7.1	<u>Domestic Card Business Results</u>	22
7.2	<u>International Card Business Results</u>	24
8	<u>Consumer Banking Business Results</u>	25
9	<u>Commercial Banking Business Results</u>	28
10	<u>Investment Securities</u>	31
11	<u>Non-Agency Investment Securities Credit Ratings</u>	33
12	<u>Net Loans Held for Investment</u>	33
13	<u>Changes in Representation and Warranty Reserve</u>	35
14	<u>Capital Ratios Under Basel I</u>	36
15	<u>Risk-Based Capital Components Under Basel I</u>	37
16	<u>Loan Portfolio Composition</u>	40
17	<u>30+ Day Delinquencies</u>	42
18	<u>Aging and Geography of 30+ Day Delinquent Loans</u>	43
19	<u>90+ Days Delinquent Loans Accruing Interest</u>	43
20	<u>Nonperforming Loans and Other Nonperforming Assets</u>	44
21	<u>Net Charge-Offs</u>	46
22	<u>Loan Modifications and Restructurings</u>	47
23	<u>Summary of Allowance for Loan and Lease Losses</u>	50
24	<u>Allocation of the Allowance for Loan and Lease Losses</u>	51
25	<u>Liquidity Reserves</u>	52
26	<u>Deposits</u>	53
27	<u>Expected Maturity Profile of Short-term Borrowings and Long-term Debt</u>	54
28	<u>Senior Unsecured Debt Credit Ratings</u>	55
29	<u>Interest Rate Sensitivity Analysis</u>	57
	<b>Supplemental Tables:</b>	
A	<u>Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures</u>	62

---

**Table of Contents**

**PART I FINANCIAL INFORMATION**

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A )**

*This MD&A should be read in conjunction with our unaudited condensed consolidated financial statements and related notes in this Report and the more detailed information contained in our 2011 Annual Report on Form 10-K ( 2011 Form 10-K ). This discussion contains forward-looking statements that are based upon management's current expectations and are subject to significant uncertainties and changes in circumstances. Please review Forward-Looking Statements for more information on the forward-looking statements in this Report. Our actual results may differ materially from those included in these forward-looking statements due to a variety of factors including, but not limited to, those described in this Report in Part II Item 1A. Risk Factors, in our 2011 Form 10-K in Part I Item 1A. Risk Factors.*

**SUMMARY OF SELECTED FINANCIAL DATA**

Below we provide selected consolidated financial data from our results of operations for the three and six months ended June 30, 2012 and 2011, and selected comparative consolidated balance sheet data as of June 30, 2012, and December 31, 2011. We also provide selected key metrics we use in evaluating our performance.

On February 17, 2012, we completed the acquisition of substantially all of the ING Direct business in the United States ( ING Direct ) from ING Groep N.V., ING Bank N.V., ING Direct N.V. and ING Direct Bancorp (the ING Direct acquisition). The ING Direct acquisition resulted in the addition of loans of \$40.4 billion, other assets of \$53.9 billion and deposits of \$84.4 billion as of the acquisition date. On May 1, 2012, pursuant to the agreement with HSBC Finance Corporation, HSBC USA Inc. and HSBC Technology and Services (USA) Inc. (collectively, HSBC), we closed the acquisition of substantially all of the assets and assumed liabilities of HSBC's credit card and private-label credit card business in the United States (other than the HSBC Bank USA, National Association consumer credit card program and certain other retained assets and liabilities) (the HSBC U.S. card acquisition). The HSBC U.S. card acquisition included (i) the acquisition of HSBC's U.S. credit card portfolio, (ii) its on-going private label and co-branded partnerships, and (iii) other assets, including infrastructure and capabilities. At closing, we acquired approximately 27 million new active accounts, approximately \$27.8 billion in outstanding credit card receivables designated as held for investment and approximately \$327 million in other net assets. The ING Direct and HSBC U.S. card acquisitions had a significant impact on our results and selected metrics for the three and six months ended June 30, 2012 and our financial condition as of June 30, 2012.

We use the term acquired loans to refer to a limited portion of the credit card loans acquired in the HSBC U.S. card acquisition and the substantial majority of consumer and commercial loans acquired in the ING Direct and Chevy Chase Bank ( CCB ) acquisitions, which were recorded at fair value at acquisition and subsequently accounted for based on expected cash flows to be collected (under the accounting standard formerly known as Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, commonly referred to as SOP 03-3). HSBC U.S. card loans accounted for based on expected cash flows consisted of loans with a fair value at acquisition of \$651 million that were deemed to be credit impaired because they were delinquent and revolving cardholder privileges had been revoked. Because the fair value recorded at acquisition and subsequent accounting for these loans takes into consideration future credit losses expected to be incurred, there are no charge-offs or an allowance associated with these loans unless the estimated cash flows expected to be collected decrease subsequent to acquisition. In addition, these loans are not classified as delinquent or nonperforming even though the customer may be contractually past due because we expect that we will fully collect the carrying value of these loans. The accounting and classification of these loans may significantly alter some of our reported credit quality metrics. We therefore supplement certain reported credit quality metrics with metrics adjusted to exclude the impact of these acquired loans.

**Table of Contents**

Of the \$27.8 billion in outstanding HSBC U.S. card loans that we acquired that were designated as held for investment, \$26.2 billion had existing revolving privileges at acquisition and were therefore excluded from the accounting guidance applied to the loans described above. These loans were recorded at fair value of \$26.9 billion at acquisition, resulting in a net premium of \$705 million at acquisition. Under applicable accounting guidance, we are required to amortize the net premium of \$705 million over the contractual principal amount as an adjustment to interest income over the remaining life of the loans. In the second quarter of 2012, we recorded provision expense of \$1.2 billion to establish an allowance primarily related to these loans. The provision expense of \$1.2 billion is included in the provision for credit losses of \$1.7 billion recorded in the second quarter of 2012. For additional information, see [Credit Risk Profile](#) and [Note 5 Loans Acquired Loans](#).

**Table 1: Consolidated Financial Highlights (Unaudited)**

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2012	2011	Change	2012	2011	Change
<b>Income statement</b>						
Net interest income	\$ 4,001	\$ 3,136	28%	\$ 7,415	\$ 6,276	18%
Non-interest income <sup>(1)</sup>	1,054	857	23	2,575	1,799	43
Total net revenue <sup>(2)</sup>	5,055	3,993	27	9,990	8,075	24
Provision for credit losses	1,677	343	389	2,250	877	157
Non-interest expense	3,142	2,255	39	5,646	4,417	28
Income from continuing operations before income taxes	236	1,395	(83)	2,094	2,781	(25)
Income tax provision	43	450	(90)	396	804	(51)
Income from continuing operations, net of taxes	193	945	(80)	1,698	1,977	(14)
Loss from discontinued operations, net of taxes <sup>(3)</sup>	(100)	(34)	(194)	(202)	(50)	(304)
Net income	93	911	(90)	1,496	1,927	(22)
Dividends and undistributed earnings allocated to participating securities	(1)		**	(8)		**
Net income available to common shareholders	\$ 92	\$ 911	(90)%	\$ 1,488	\$ 1,927	(23)%
<b>Common share statistics</b>						
Earnings per common share:						
Basic earnings per common share	\$ 0.16	\$ 2.00	(92)%	\$ 2.74	\$ 4.24	(35)%
Diluted earnings per common share	0.16	1.97	(92)	2.72	4.18	(35)
Weighted average common shares outstanding:						
Basic earnings per common share	577.7	455.6	27	543.3	454.9	19
Diluted earnings per common share	582.8	462.2	26	548.0	461.3	19
Dividends per common share	0.05	0.05		0.10	0.10	
<b>Average balances</b>						
Loans held for investment <sup>(4)</sup>	\$ 192,632	\$ 127,916	51%	\$ 172,767	\$ 126,504	37%
Interest-earning assets	265,019	174,113	52	237,667	173,779	37
Total assets	295,306	199,229	48	270,786	198,612	36
Interest-bearing deposits	195,597	109,251	79	173,611	108,944	59
Total deposits	214,914	125,834	71	192,586	125,001	54
Borrowings	35,418	39,451	(10)	35,706	39,991	(11)
Stockholders' equity	37,533	28,255	33	35,258	27,636	28

**Table of Contents**

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2012	2011	Change	2012	2011	Change
<b>Selected performance metrics</b>						
Purchase volume <sup>(5)</sup>	\$ 45,228	\$ 34,226	32%	\$ 79,726	\$ 62,023	29%
Total net revenue margin <sup>(6)</sup>	7.63%	9.17%	(154)bps	8.41%	9.29%	(88)bps
Net interest margin <sup>(7)</sup>	6.04	7.20	(116)	6.24	7.22	(98)
Net charge-offs	\$ 738	\$ 931	(21)%	\$ 1,518	\$ 2,076	(27)%
Net charge-off rate <sup>(8)</sup>	1.53%	2.91%	(138)bps	1.76%	3.28%	(152)bps
Net charge-off rate (excluding acquired loans) <sup>(9)</sup>	1.96	3.03	(107)	2.17	3.42	(125)
Return on average assets <sup>(10)</sup>	0.26	1.90	(164)	1.25	1.99	(74)
Return on average stockholders' equity <sup>(11)</sup>	2.06	13.38	(1132)	9.63	14.31	(468)
Non-interest expense as a % of average loans held for investment <sup>(12)</sup>	6.52	7.05	(53)	6.54	6.98	(44)
Efficiency ratio <sup>(13)</sup>	62.16	56.47	569	56.52	54.70	182
Effective income tax rate	18.2	32.3	(1410)	18.9	28.9	(1000)

(Dollars in millions)	June 30, 2012	December 31, 2011	Change
<b>Balance sheet (period end)</b>			
Loans held for investment	\$ 202,749	\$ 135,892	49%
Interest-earning assets	264,331	179,878	47
Total assets	296,572	206,019	44
Interest-bearing deposits	193,859	109,945	76
Total deposits	213,931	128,226	67
Borrowings	35,874	39,561	(9)
Total liabilities	259,380	176,353	47
Stockholders' equity	37,192	29,666	25
<b>Credit quality metrics (period end)</b>			
Allowance for loan and lease losses	\$ 4,998	\$ 4,250	18%
Allowance as a % of loans held of investment	2.47%	3.13%	(66)bps
Allowance as a % of loans held of investment (excluding acquired loans) <sup>(9)</sup>	3.08	3.22	(14)
30+ day performing delinquency rate	2.06	3.35	(129)
30+ day performing delinquency rate (excluding acquired loans) <sup>(9)</sup>	2.59	3.47	(88)
30+ day delinquency rate	2.43	3.95	(152)
30+ day delinquency rate (excluding acquired loans) <sup>(9)</sup>	3.06	4.09	(103)
<b>Capital ratios<sup>(14)</sup></b>			
Tier 1 common ratio <sup>(15)</sup>	9.9%	9.7%	20bps
Tier 1 risk-based capital ratio <sup>(16)</sup>	11.6	12.0	(40)
Total risk-based capital ratio <sup>(17)</sup>	14.0	14.9	(90)
Tangible common equity ratio (TCE ratio) <sup>(18)</sup>	7.4	8.2	(80)
<b>Associates</b>			
Full-time equivalent employees (in thousands)	37.4	30.5	23%



**Table of Contents**

\*\* Change is less than one percent or not meaningful.

- (1) Includes a bargain purchase gain of \$594 million attributable to the ING Direct acquisition recognized in non-interest income in the first quarter and first six months of 2012. The bargain purchase gain represents the excess of the fair value of the net assets acquired from ING Direct as of the acquisition date over the consideration transferred. See Note 2 Acquisitions for additional information.
- (2) Total net revenue was reduced by \$311 million and \$112 million for the three months ended June 30, 2012 and 2011, respectively and \$434 million and \$217 million for the six months ended June 30, 2012 and 2011, respectively, for the estimated uncollectible amount of billed finance charges and fees.
- (3) Discontinued operations reflect ongoing costs related to the mortgage origination operations of GreenPoint's wholesale mortgage banking unit, GreenPoint Mortgage Funding, Inc. (GreenPoint), which we closed in 2007.
- (4) Loans held for investment includes loans acquired in the HSBC U.S. card, ING Direct and Chevy Chase Bank acquisitions. The carrying value of acquired loans accounted for subsequent to acquisition based on expected cash flows to be collected was \$41.7 billion and \$4.7 billion as of June 30, 2012 and December 31, 2011, respectively. The average balance of loans held for investment, excluding the carrying value of acquired loans, was \$150.5 billion and \$122.8 billion for the three months ended June 30, 2012 and 2011, respectively, and \$140.1 billion and \$121.3 billion for the six months ended June 30, 2012 and 2011, respectively. See Note 5 Loans for additional information.
- (5) Consists of credit card purchase transactions for the period, net of returns. Excludes cash advance transactions.
- (6) Calculated based on annualized total net revenue for the period divided by average interest-earning assets for the period.
- (7) Calculated based on annualized net interest income for the period divided by average interest-earning assets for the period.
- (8) Calculated based on annualized net charge-offs for the period divided by average loans held for investment for the period.
- (9) Calculation of ratio adjusted to exclude from the denominator acquired loans accounted for subsequent to acquisition based on expected cash flows to be collected. See Business Segment Financial Performance, Credit Risk Profile and Note 5 Loans Credit Quality for additional information on the impact of acquired loans on our credit quality metrics.
- (10) Calculated based on annualized income from continuing operations, net of tax, for the period divided by average total assets for the period.
- (11) Calculated based on annualized income from continuing operations, net of tax, for the period divided by average stockholders' equity for the period.
- (12) Calculated based on annualized non-interest expense, excluding goodwill impairment charges, for the period divided by average loans held for investment for the period.
- (13) Calculated based on non-interest expense, excluding goodwill impairment charges, for the period divided by total revenue for the period.
- (14) Regulatory capital ratios as of June 30, 2012 are preliminary and therefore subject to change.
- (15) Tier 1 common ratio is a regulatory capital measure calculated based on Tier 1 common capital divided by risk-weighted assets. See Capital Management and Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for additional information, including the calculation of this ratio.
- (16) Tier 1 risk-based capital ratio is a regulatory measure calculated based on Tier 1 capital divided by risk-weighted assets. See Capital Management and Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for additional information, including the calculation of this ratio.
- (17) Total risk-based capital ratio is a regulatory measure calculated based on total risk-based capital divided by risk-weighted assets. See Capital Management and Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for additional information, including the calculation of this ratio.
- (18) TCE ratio is a non-GAAP measure calculated based on tangible common equity divided by tangible assets. See Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for the calculation of this measure and reconciliation to the comparative GAAP measure.

---

**Table of Contents**

**INTRODUCTION**

We are a diversified financial services holding company with banking and non-banking subsidiaries that offer a broad array of financial products and services to consumers, small businesses and commercial clients through branches, the internet and other distribution channels. Our principal subsidiaries include Capital One Bank (USA), National Association ( COBNA ), Capital One, National Association ( CONA ) and ING Bank, fsb. The Company and its subsidiaries are hereafter collectively referred to as we, us or our. CONA and COBNA are hereafter collectively referred to as the Banks. We continue to deliver on our strategy of combining the power of national scale lending and local scale banking.

The closing of the ING Direct acquisition in the first quarter of 2012 resulted in the addition of loans of \$40.4 billion and other assets of \$53.9 billion at acquisition. The ING Direct acquisition, which added over seven million customers and approximately \$84.4 billion in deposits to our Consumer Banking business segment as of the acquisition date, strengthens our customer franchise. With the ING Direct acquisition, we have grown to become the sixth largest depository institution and the largest direct banking institution in the United States. The closing of the HSBC U.S. card acquisition in the second quarter of 2012 added approximately 27 million new active accounts and approximately \$27.8 billion in outstanding credit card receivables as of the acquisition date that we designated as held for investment. Period-end loans held for investment increased to \$202.7 billion and deposits increased to \$213.9 billion as of June 30, 2012, up from period-end loans of \$135.9 billion and deposits of \$128.2 billion as of December 31, 2011.

Our revenues 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, such as fee-based services provided to customers, merchant interchange fees with respect to certain credit card transactions, gains and losses and fees associated with the sale and servicing of loans. Our expenses primarily consist of the cost of funding our assets, our provision for credit losses, operating expenses (including associate salaries and benefits, infrastructure maintenance and enhancements and branch operations and expansion costs), marketing expenses and income taxes.

Our principal operations are currently organized, for management reporting purposes, into three primary business segments, which are defined primarily based on the products and services provided or the type of customer served: Credit Card, Consumer Banking and Commercial Banking. The operations of acquired businesses have been integrated into our existing business segments. The acquired HSBC U.S. card business is reflected in our Credit Card business, while the acquired ING Direct business is primarily reflected in our Consumer Banking business. Certain activities that are not part of a segment are included in our Other category.

*Credit Card:* Consists of our domestic consumer and small business card lending, national small business lending, national closed end installment lending and the international card lending businesses in Canada and the United Kingdom.

*Consumer Banking:* Consists of our branch-based lending and deposit gathering activities for consumers and small businesses, national deposit gathering, national auto lending and consumer home loan lending and servicing activities.

*Commercial Banking:* Consists of our lending, deposit gathering and treasury management services to commercial real estate and commercial and industrial customers. Our commercial and industrial customers typically include companies with annual revenues between \$10 million to \$1.0 billion.

In the first quarter of 2012, we re-aligned the reporting of our Commercial Banking business to reflect the operations on a product basis rather than by customer type. Table 2 summarizes our business segment results, which we report based on income from continuing operations, net of tax, for the three and six months ended June 30, 2012 and 2011. We provide additional information on the realignment of our Commercial Banking business segment below under Business Segment Results and in Note 14 Business Segments of this

**Table of Contents**

Report. We also provide a reconciliation of our total business segment results to our consolidated U.S. GAAP results in Note 14 Business Segments.

**Table 2: Business Segment Results**

(Dollars in millions)	Three Months Ended June 30,							
	2012				2011			
	Total Net Revenue <sup>(1)</sup>		Net Income (Loss) <sup>(2)</sup>		Total Net Revenue <sup>(1)</sup>		Net Income (Loss) <sup>(2)</sup>	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Credit Card	\$ 3,121	62%	\$ (297)	(154)%	\$ 2,509	63%	\$ 618	66%
Consumer Banking	1,681	33	438	227	1,245	31	287	30
Commercial Banking	509	10	228	118	450	11	159	17
Other <sup>(3)</sup>	(256)	(5)	(176)	(91)	(211)	(5)	(119)	(13)
<b>Total from continuing operations</b>	<b>\$ 5,055</b>	<b>100%</b>	<b>\$ 193</b>	<b>100%</b>	<b>\$ 3,993</b>	<b>100%</b>	<b>\$ 945</b>	<b>100%</b>

(Dollars in millions)	Six Months Ended June 30,							
	2012				2011			
	Total Net Revenue <sup>(1)</sup>		Net Income (Loss) <sup>(2)</sup>		Total Net Revenue <sup>(1)</sup>		Net Income (Loss) <sup>(2)</sup>	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Credit Card	\$ 5,711	57%	\$ 269	16%	\$ 5,124	63%	\$ 1,261	64%
Consumer Banking	3,145	32	662	39	2,414	30	502	25
Commercial Banking	1,025	10	438	26	897	11	321	16
Other <sup>(3)</sup>	109	1	329	19	(360)	(4)	(107)	(5)
<b>Total from continuing operations</b>	<b>\$ 9,990</b>	<b>100%</b>	<b>\$ 1,698</b>	<b>100%</b>	<b>\$ 8,075</b>	<b>100%</b>	<b>\$ 1,977</b>	<b>100%</b>

(1) Total net revenue consists of net interest income and non-interest income.

(2) Net income for our business segments is reported based on income from continuing operations, net of tax.

(3) Includes the residual impact of the allocation of our centralized Corporate Treasury group activities, such as management of our corporate investment portfolio and asset/liability management, to our business segments as well as other items as described in Note 14 Business Segments.

**EXECUTIVE SUMMARY AND BUSINESS OUTLOOK**

With the close of the HSBC U.S. card acquisition on May 1, 2012, we have now completed both of the acquisitions announced in 2011, and we are devoting significant effort to the integration of ING Direct and HSBC's U.S. card business. While we expect that the combined Capital One, ING Direct and HSBC businesses will deliver attractive financial results and strong capital generation, the HSBC U.S. card acquisition had a significant impact on our second quarter 2012 results, primarily due to the post-acquisition impact of a number of purchase accounting adjustments and the establishment of an allowance for loan and lease losses and finance charge and fee reserve for HSBC loans as of the end of

the quarter.

**Financial Highlights**

The post-acquisition impact of purchase accounting adjustments and other charges related to the HSBC U.S. card acquisition, coupled with charges associated with other items, reduced our net income to \$92 million (\$0.16 per diluted share) for the second quarter of 2012 on total net revenue of \$5.1 billion. In comparison, we reported net income of \$1.4 billion (\$2.72 per diluted share) for the first quarter of 2012 on total net revenue of \$4.9 billion,

**Table of Contents**

and net income of \$911 million (\$1.97 per diluted share) for the second quarter of 2011 on total net revenue of \$4.0 billion. Net income totaled \$1.5 billion (\$2.72 per diluted share) for the first six months of 2012, compared with net income of \$1.9 billion (\$4.18 per diluted share) for the first six months of 2011.

The primary post-acquisition charges relative to the HSBC U.S. card acquisition that affected our results for the second quarter of 2012 included a provision for credit losses of \$1.2 billion, which was primarily related to the \$26.2 billion in outstanding HSBC U.S. credit card receivables recorded at a fair value of \$26.9 billion and designated as held for investment that had existing revolving privileges at acquisition and were therefore accounted for based on contractual cash flows, a charge of \$174 million to establish a reserve for estimated uncollectible billed finance charges and fees for these loans and merger-related expenses, including transaction costs, of \$106 million.

Our second quarter results also reflect the unfavorable impact of charges related to certain other items, including \$60 million for civil penalties and \$41 million for expected customer refunds related to regulatory settlements pertaining to cross-sell activities in our Domestic Card business, a \$180 million provision for repurchase losses related to mortgage representations and warranties, of which \$154 million was recorded in discontinued operations, and \$98 million for legal costs related to interchange and other settlements during the quarter. For more information on these regulatory settlements and related matters, please see *Supervision and Regulation* Required Enhancements to Compliance and Risk Management Programs.

The HSBC U.S. card acquisition and related purchase accounting adjustments resulted in a significant increase in risk-weighted assets and a reduction in our regulatory capital ratios at the end of the second quarter. Our Tier 1 common ratio was 9.9% as of June 30, 2012, compared with 11.9% as of March 31, 2012 and 9.7% as of December 31, 2011. Our Tier 1 risk-based capital ratio was 11.6% as of June 30, 2012, compared with 13.9% as of March 31, 2012 and 12.0% as of December 31, 2011. The increases in our regulatory capital ratios during the first quarter of 2012 were largely due to equity issuances during the quarter.

Below are additional highlights of our performance for the second quarter and first six months of 2012. These highlights generally are based on a comparison to the same prior year periods, except as otherwise noted. The changes in our financial condition and credit performance are generally based on our financial condition and credit performance as of June 30, 2012, compared with our financial condition and credit performance as of December 31, 2011. We provide a more detailed discussion of our financial performance in the sections following this Executive Summary and Business Outlook.

**Total Company**

*Earnings:* Our net income of \$92 million for the second quarter of 2012 decreased by \$819 million, or 90%, from the second quarter of 2011, while our net income of \$1.5 billion for the first six months of 2012 decreased by \$439 million, or 23%, from the first six months of 2011. The decrease in net income in the second quarter of 2012 was driven primarily by the post-acquisition charges related to the HSBC U.S. card acquisition and the other charges discussed above. The decrease in net income in the first six months of 2012 was also driven by the post-acquisition charges related to the HSBC U.S. card acquisition and other charges recorded in the second quarter of 2012 discussed above as well higher operating expenses related to our recent acquisitions and higher infrastructure costs from our continued investments in our home loan business and growth in auto originations. The impact from these items was partially offset by the favorable impact from the bargain purchase gain of \$594 million attributable to ING Direct acquisition recorded in the first quarter of 2012 and higher revenue from our legacy businesses.

*Total Loans:* Period-end loans held for investment increased by \$66.8 billion, or 49%, during the first six months of 2012, to \$202.7 billion as of June 30, 2012, from \$135.9 billion as of December 31, 2011. The increase was primarily attributable to the additions of the acquired ING Direct loan portfolio of \$40.4 billion and the \$27.8 billion in outstanding HSBC U.S. card loans that we acquired and classified as held for

**Table of Contents**

investment. Excluding the impact of the addition of the acquired ING Direct and HSBC U.S. card loan portfolios designated as held for investment, period-end loans held for investment decreased by \$1.2 billion, or 1%. The decrease was largely due to normal seasonal credit card pay downs and the continued run-off of installment loans in our Credit Card business, which was partially offset by auto loan growth that outpaced the expected home loan run-off in our Consumer Banking business.

*Charge-off and Delinquency Statistics:* The net charge-off rate decreased to 1.53% in the second quarter of 2012, from 2.04% in the first quarter of 2012, and 2.91% in the second quarter of 2011. The 30+ day delinquency rate decreased to 2.43% as of June 30, 2012, from 2.69% as of March 31, 2012 and 3.95% as of December 31, 2011. Our credit trends remain relatively stable at historically strong levels, with normal seasonal patterns and some continued improvement across our legacy card portfolio. The addition of the acquired ING Direct and HSBC loan portfolios and related accounting has contributed to some of the improvement in our net charge-off and delinquency metrics. We provide information on our credit quality metrics, excluding the impact of acquired loans accounted for based on estimated cash flows expected to be collected, below under **Business Segments** and **Credit Risk Profile**.

*Allowance for Loan and Lease Losses:* We increased our allowance by \$938 million in the second quarter of 2012 and by \$748 million in the first six months of 2012 to \$5.0 billion as of June 30, 2012. The increase was primarily driven by the establishment of an allowance for HSBC U.S. card loans of \$1.2 billion for estimated incurred losses inherent in the portfolio as of the end of the quarter. Although the allowance increased, the coverage ratio of the allowance to total loans held for investment fell by 66 basis points to 2.47% as of June 30, 2012, from 3.13% as of December 31, 2011. The decrease in the allowance coverage ratio was largely due to the addition of the acquired HSBC U.S. card and ING Direct loans accounted for based on estimated cash flows expected to be collected. As discussed above, because the accounting for these loans takes into consideration future credit losses expected to be incurred, there are no charge-offs or an allowance associated with these loans unless the estimated cash flows expected to be collected decrease subsequent to acquisition. We did not have an allowance associated with these loans as of June 30, 2012.

*Representation and Warranty Provision:* We recorded a provision for mortgage repurchase losses of \$180 million and \$349 million in the second quarter and first six months of 2012, respectively, compared with a provision of \$37 million and \$81 million in the second quarter and first six months of 2011, respectively. The increase in the provision for repurchase losses was primarily driven by updated estimates of anticipated outcomes from various litigation and threatened litigation in the insured securitization segment based on relevant factual and legal developments and a first quarter settlement between a subsidiary and a GSE to resolve present and future claims. We provide additional information on the representation and warranty reserve in **Note 15 Commitments, Contingencies and Guarantees**.

***Business Segments***

*Credit Card:* Our Credit Card business recorded a net loss from continuing operations of \$297 million and net income from continuing operations of \$269 million in the second quarter and first six months of 2012, respectively, compared with net income from continuing operations of \$618 million and \$1.3 billion in the second quarter and first six months of 2011, respectively. The results for our Credit Card business for the second quarter and first six months of 2012 were significantly impacted by the post-acquisition impact of purchase accounting adjustments and other charges related to the HSBC U.S. card acquisition, which more than offset an increase in total net revenue, due in part to the an increase in average loan balances and fees resulting from the addition of the HSBC U.S. card portfolio.

*Consumer Banking:* Our Consumer Banking business generated net income from continuing operations of \$438 million and \$662 million in the second quarter and first six months of 2012, respectively, compared with net income from continuing operations of \$287 million and \$502 million in the second quarter and first six months of 2011, respectively. The increase in earnings was attributable to growth in total net revenue, which was partially offset by higher non-interest expense and an increase in the provision for credit losses. Growth in revenue stemmed from higher average loan balances resulting from increased auto loan

## **Table of Contents**

originations over the past year and added home loans from the ING Direct acquisition. The increase in non-interest expense was largely due to operating expenses associated with ING Direct, higher infrastructure expenditures resulting from continued investments in our home loan business and growth in auto originations and modestly higher marketing expenditures in our retail banking operations. The increase in the provision for credit losses was largely due to increased loan balances due to growth in auto loan originations, as net charge-offs declined as a result of continued credit performance improvements.

*Commercial Banking:* Our Commercial Banking business generated net income from continuing operations of \$228 million and \$438 million in the second quarter and first six months of 2012, respectively, compared with net income from continuing operations of \$159 million and \$321 million in the second quarter and first six months of 2011, respectively. The improvement in results for Commercial Banking was attributable to an increase in revenues driven by increased average loan balances as well as loan spreads and a decrease in the provision for credit losses due to improving credit trends. These factors were partially offset by higher non-interest expense resulting from operating costs associated with the increased volume of loan originations in our commercial real estate and commercial and industrial business, increased infrastructure expenditures and the expansion into new markets.

## **Business Outlook**

We discuss below our current expectations regarding our total company performance and the performance of each of our business segments over the near-term based on market conditions, the regulatory environment and our business strategies as of the time we filed this Quarterly Report on Form 10-Q. The statements contained in this section are based on our current expectations regarding our outlook for our financial results and business strategies. Our expectations take into account, and should be read in conjunction with, our expectations regarding economic trends and analysis of our business as discussed in Part I Item 1. Business and Part I Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2011 Form 10-K. 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. Forward-looking statements do not reflect: (i) any change in current dividend or repurchase strategies, (ii) the effect of any acquisitions, divestitures or similar transactions, except for the forward-looking statements specifically discussing the acquisition of ING Direct or of HSBC's U.S. credit card business, or (iii) any changes in laws, regulations or regulatory interpretations, in each case after the date as of which such statements are made. See Forward-Looking Statements in this Quarterly Report on Form 10-Q for more information on the forward-looking statements in this report and Item 1A. Risk Factors in our 2011 Form 10-K for factors that could materially influence our results.

## ***Total Company Expectations***

Our strategies and actions are designed to deliver and sustain strong returns and capital generation through the acquisition and retention of franchise-enhancing customer relationships across our businesses. We believe that franchise-enhancing customer relationships produce strong long-term economics through low credit costs, low customer attrition and a gradual build in loan balances and revenues over time. Examples of franchise-enhancing customer relationships include rewards customers and new partnerships in our Credit Card business, retail deposit customers in our Consumer Banking business and primary banking relationships with commercial customers in our Commercial Banking business. We intend to grow these customer relationships by continuing to invest in our bank infrastructure to allow us to provide more convenient and flexible customer banking options, including a broader range of fee-based and credit products and services, by leveraging our direct bank customer franchise with national reach and by continued marketing investments to attract and retain credit card and auto finance customers and further strengthen our brand. The acquisitions of ING Direct and HSBC's U.S. credit card business will strengthen and expand our customer base, and, over time, we expect to expand and deepen our customer relationships with new products and services.

## **Table of Contents**

We believe our actions have created a well-positioned balance sheet and capital and liquidity levels which have provided us with investment flexibility to take advantage of attractive organic growth opportunities and adjust, where we believe appropriate, to changing market conditions. We believe that combining the businesses of Capital One, ING Direct and the HSBC's U.S. credit card business will deliver attractive financial results, strong capital generation and sustained shareholder value.

### ***Business Segment Expectations***

#### ***Credit Card Business***

In Domestic Card, the closing of the HSBC U.S. card acquisition has impacted and will continue to affect quarterly trends in loan growth, revenue margin and credit metrics. We anticipate that the run-off of parts of the portfolios acquired in the HSBC Transaction will continue to offset the underlying growth trajectory in other parts of our Domestic Card business resulting in relatively flat loan balances. We anticipate that the credit mark on the non-revolving credit card loans acquired in the HSBC U.S. card acquisition will continue to absorb most of the HSBC credit losses in the third quarter of 2012, which will have the effect of temporarily lowering the overall charge-off rate of the Domestic Card segment. We expect that the Domestic Card charge-off rate will increase in the fourth quarter of 2012. Over time, we expect the charge-off rate on the combined card business to reach a level that is between 40 and 60 basis points higher than the stand-alone charge-off rate for Capital One's stand-alone Domestic Card business. Once the acquisition-related impacts on the charge-off rate play out, we expect charge-off levels to remain relatively stable with normal seasonal patterns. When we announced the HSBC U.S. card acquisition, we planned to take certain actions to bring HSBC customer practices into alignment with our customer practices. All else being equal, we expect that they will put downward pressure on Domestic Card revenue margin over the next several quarters. We expect that Domestic Card revenue margin will be impacted by the competitive environment, the timing and pace of growth and runoff in Domestic Card loan balances, credit trends, and other factors, most of which are difficult to predict. We expect our Domestic Card business to deliver strong and resilient profitability and a strong customer franchise.

#### ***Consumer Banking Business***

In our Consumer Banking business, we expect the ING Direct acquisition to continue to have a significant impact on Consumer Banking loan volumes as the acquired Home Loans portfolio runs off. We anticipate that the Consumer Banking business will continue to gain traction, with national scale auto lending, local scale in attractive local markets and growing national reach through ING Direct.

#### ***Commercial Banking Business***

Our Commercial Banking business continues to grow loans, deposits, and revenues as we attract new customers and deepen relationships with existing customers. Although we anticipate some quarterly fluctuations in nonperforming loan and charge-off rates, we expect our Commercial Banking business to continue strong and relatively steady performance trends throughout 2012.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in accordance with U.S. Generally Accepted Accounting Principles ( GAAP ) requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We provide a summary of our significant accounting policies in Note 1 Summary of Significant Accounting Policies of our 2011 Form 10-K.



## **Table of Contents**

In the MD&A Critical Accounting Policies and Estimates section of our 2011 Form 10-K, we identified the following accounting policies as critical because they require significant judgments and assumptions about highly complex and inherently uncertain matters and the use of reasonably different estimates and assumptions could have a material impact on our reported results of operations or financial condition.

- Loan loss reserves
- Representation and warranty reserve
- Asset impairment
- Fair value
- Derivative and hedge accounting
- Income taxes

We evaluate our critical accounting estimates and judgments on an ongoing basis and update them as necessary based on changing conditions. Management has reviewed and approved these critical accounting policies and has discussed our judgments and assumptions with the Audit and Risk Committee of the Board of Directors. There has been no material changes in the methods used to formulate these critical accounting estimates from those discussed in the MD&A Critical Accounting Policies and Estimates section of our 2011 Form 10-K.

## **CONSOLIDATED RESULTS OF OPERATIONS**

The section below provides a comparative discussion of our consolidated financial performance for the three and six months ended June 30, 2012 and 2011. Following this section, we provide a discussion of our business segment results. You should read this section together with our Executive Summary and Business Outlook where we discuss trends and other factors that we expect will affect our future results of operations.

### **Net Interest Income**

Net interest income represents the difference between the interest income and applicable fees earned on our interest-earning assets, which include loans held for investment and investment securities, and the interest expense on our interest-bearing liabilities, which include interest-bearing deposits, senior and subordinated notes, securitized debt and other borrowings. We include in interest income any past due fees on loans that we deem are collectible. Our net interest margin represents the difference between the yield on our interest-earning assets and the cost of our interest-bearing liabilities, including the impact of non-interest bearing funding. We expect net interest income and our net interest margin to fluctuate based on changes in interest rates and changes in the amount and composition of our interest-earning assets and interest-bearing liabilities.

Table 3 below presents, for each major category of our interest-earning assets and interest-bearing liabilities, the average outstanding balances, interest income earned or interest expense incurred, and average yield or cost for the three and six months ended June 30, 2012 and 2011.

**Table of Contents****Table 3: Average Balances, Net Interest Income and Net Interest Yield**

(Dollars in millions)	Average Balance	Three Months Ended June 30,			2011 Interest Income/ Expense <sup>(1)</sup>	Yield/ Rate
		2012 Interest Income/ Expense <sup>(1)</sup>	Yield/ Rate	Average Balance		
<b>Assets:</b>						
Interest-earning assets:						
Consumer loans: <sup>(2)</sup>						
Domestic	\$ 149,211	\$ 3,589	9.62%	\$ 88,515	\$ 2,656	12.00%
International	8,194	290	14.18	8,823	348	15.77
Total consumer loans	157,405	3,879	9.86	97,338	3,004	12.34
Commercial loans	35,227	376	4.27	30,578	363	4.75
Total loans held for investment	192,632	4,255	8.84	127,916	3,367	10.53
Investment securities	56,972	335	2.35	40,381	313	3.10
Other interest-earning assets	15,415	26	0.67	5,816	19	1.31
Total interest-earning assets	\$ 265,019	\$ 4,616	6.97%	\$ 174,113	\$ 3,699	8.50%
Cash and due from banks	2,245			1,870		
Allowance for loan and lease losses	(4,065)			(5,069)		
Premises and equipment, net	3,316			2,715		
Other assets	28,791			25,600		
Total assets	\$ 295,306			\$ 199,229		
<b>Liabilities and stockholders equity:</b>						
Interest-bearing liabilities:						
Deposits	\$ 195,597	\$ 373	0.76%	\$ 109,251	\$ 307	1.12%
Securitized debt obligations	14,948	69	1.85	22,191	113	2.04
Senior and subordinated notes	11,213	87	3.10	8,093	63	3.11
Other borrowings	9,257	86	3.72	9,167	80	3.49
Total interest-bearing liabilities	\$ 231,015	\$ 615	1.06%	\$ 148,702	\$ 563	1.51%
Non-interest bearing deposits	19,316			16,583		
Other liabilities	7,442			5,689		
Total liabilities	257,773			170,974		
Stockholders equity	37,533			28,255		
Total liabilities and stockholders equity	\$ 295,306			\$ 199,229		
Net interest income/spread		\$ 4,001	5.90%		\$ 3,136	6.99%
Impact of non-interest bearing funding			0.14			0.21
Net interest margin			6.04%			7.20%



**Table of Contents**

(Dollars in millions)	Six Months Ended June 30,					
	Average Balance	2012 Interest Income/Expense <sup>(1)</sup>	Yield/Rate	Average Balance	2011 Interest Income/Expense <sup>(1)</sup>	Yield/Rate
<b>Assets:</b>						
Interest-earning assets:						
Consumer loans: <sup>(2)</sup>						
Domestic	\$ 129,889	\$ 6,523	10.04%	\$ 87,440	\$ 5,358	12.26%
International	8,248	631	15.29	8,760	702	16.02
Total consumer loans	138,137	7,154	10.36	96,200	6,060	12.60
Commercial loans	34,630	756	4.37	30,304	724	4.78
Total loans held for investment	172,767	7,910	9.16	126,504	6,784	10.73
Investment securities	53,757	633	2.36	40,953	629	3.07
Other interest-earning assets	11,143	52	0.93	6,322	38	1.20
Total interest-earning assets	\$ 237,667	\$ 8,595	7.23%	\$ 173,779	\$ 7,451	8.57%
Cash and due from banks	7,141			1,912		
Allowance for loan and lease losses	(4,200)			(5,348)		
Premises and equipment, net	3,107			2,717		
Other assets	27,071			25,552		
Total assets	\$ 270,786			\$ 198,612		
<b>Liabilities and stockholders equity:</b>						
Interest-bearing liabilities:						
Deposits	\$ 173,611	\$ 684	0.79%	\$ 108,944	\$ 629	1.15%
Securitized debt obligations	15,567	149	1.91	23,852	253	2.12
Senior and subordinated notes	10,740	175	3.26	8,091	127	3.14
Other borrowings	9,399	172	3.66	8,048	166	4.13
Total interest-bearing liabilities	\$ 209,317	\$ 1,180	1.13%	\$ 148,935	\$ 1,175	1.58%
Non-interest bearing deposits	18,975			16,057		
Other liabilities	7,236			5,984		
Total liabilities	235,528			170,976		
Stockholders equity	35,258			27,636		
Total liabilities and stockholders equity	\$ 270,786			\$ 198,612		
Net interest income/spread		\$ 7,415	6.11%		\$ 6,276	6.99%
Impact of non-interest bearing funding			0.13			0.23
Net interest margin			6.24%			7.22%

<sup>(1)</sup> Past due fees included in interest income totaled approximately \$369 million and \$245 million for the three months ended June 30, 2012 and 2011, respectively, and approximately \$652 million and \$490 million for the six months ended June 30, 2012 and 2011, respectively.

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

- <sup>(2)</sup> Interest income on credit card, auto, home and retail banking loans is reflected in consumer loans. Interest income generated from small business credit card loans also is included in consumer loans.

**Table of Contents**

Table 4 presents the variances between our net interest income for the three and six months ended June 30, 2012 and 2011, and the extent to which the variance was attributable to: (i) changes in the volume of our interest-earning assets and interest-bearing liabilities or (ii) changes in the interest rates of these assets and liabilities.

**Table 4: Rate/Volume Analysis of Net Interest Income<sup>(1)</sup>**

	Three Months Ended June 30, 2012 vs. 2011			Six Months Ended June 30, 2012 vs. 2011		
	Total	Variance Due to		Total	Variance Due to	
(Dollars in millions)	Variance	Volume	Rate	Variance	Volume	Rate
<b>Interest income:</b>						
Loans held for investment:						
Consumer loans	\$ 875	\$ 1,572	\$ (697)	\$ 1,094	\$ 2,308	\$ (1,214)
Commercial loans	13	52	(39)	32	98	(66)
Total loans held for investment, including past-due fees	888	1,624	(736)	1,126	2,406	(1,280)
Investment securities	22	109	(87)	4	170	(166)
Other	7	20	(13)	14	24	(10)
Total interest income	917	1,753	(836)	1,144	2,600	(1,456)
<b>Interest expense:</b>						
Deposits	66	187	(121)	55	296	(241)
Securitized debt obligations	(44)	(34)	(10)	(104)	(81)	(23)
Senior and subordinated notes	24	24		48	43	5
Other borrowings	6	1	5	6	26	(20)
Total interest expense	52	178	(126)	5	284	(279)
Net interest income	\$ 865	\$ 1,575	\$ (710)	\$ 1,139	\$ 2,316	\$ (1,177)

<sup>(1)</sup> We calculate the change in interest income and interest expense separately for each item. The change in net interest income attributable to both volume and rates is allocated based on the relative dollar amount of each item.

Net interest income of \$4.0 billion for the second quarter of 2012 increased by \$865 million, or 28%, from the second quarter of 2011, driven by a 52% increase in average interest-earning assets, which was partially offset by a 16% decline in our net interest margin to 6.04%.

Net interest income of \$7.4 billion for the first six months of 2012 increased by \$1.1 billion, or 18%, from the first six months 2011, driven by a 37% increase in average interest-earning assets, which was partially offset by a 14% decline in our net interest margin to 6.24%.

*Average Interest-Earning Assets:* The increase in average interest-earning assets reflects the addition of the ING Direct loan portfolio of \$40.4 billion in the first quarter of 2012, the addition of the \$27.8 billion in outstanding HSBC U.S. card loans that we acquired and designated as held for investment in the second quarter of 2012 and a significant increase in auto loan originations over the past twelve months.

*Net Interest Margin:* The decrease in our net interest margin was attributable to a decline in the average yield on our interest-earning assets, due in part to lower yields in Domestic Card resulting from the establishment of a finance charge and fee reserve of \$174 million

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

for the acquired HSBC U.S. card loan portfolio and premium amortization expense related to the acquired loans of \$63 million, which was partially mitigated by an improvement in our cost of funds. The decline in average yield also reflected the shift in the mix of our interest-earning assets as a result of the addition of ING Direct assets and temporarily higher cash balances from the recent equity and debt offerings, which had the effect of diluting the net interest margin. The ING Direct interest-earning assets generally have lower yields than our legacy loan and

**Table of Contents**

the investment security portfolios. The decrease in the average yield on interest-earnings assets was partially offset by a reduction in our cost of funds. We have continued to benefit from the shift in the mix of our funding to lower cost consumer and commercial banking deposits from higher cost wholesale sources and a decline in deposit interest rates as a result of the continued overall low interest rate environment.

**Non-Interest Income**

Non-interest income primarily consists of service charges and other customer-related fees, interchange income (net of rewards expense) and other non-interest income. The servicing fees, finance charges, other fees, net of charge-offs and interest paid to third party investors related to our consolidated securitization trusts are reported as a component of non-interest income. We also record the provision for mortgage repurchase losses related to continuing operations in non-interest income. The other component of non-interest income includes gains and losses on derivatives not accounted for in hedge accounting relationships and gains and losses from the sale of investment securities, which we generally do not allocate to our business segments because they relate to centralized asset/liability and market risk management activities undertaken by our Corporate Treasury group.

Table 5 displays the components of non-interest income for the three and six months ended June 30, 2012 and 2011.

**Table 5: Non-Interest Income**

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Service charges and other customer-related fees	\$ 539	\$ 460	\$ 954	\$ 985
Interchange fees, net	408	331	736	651
Bargain purchase gain <sup>(1)</sup>			594	
Net other-than-temporary impairment ( OTTI )	(13)	(6)	(27)	(9)
Other non-interest income:				
Provision for mortgage repurchase losses <sup>(2)</sup>	(25)	(4)	(42)	(9)
Other	145	76	360	181
Total other non-interest income	120	72	318	172
Total non-interest income	\$ 1,054	\$ 857	\$ 2,575	\$ 1,799

<sup>(1)</sup> Represents the excess of the fair value of the net assets acquired in the ING Direct acquisition as of the acquisition date of February 17, 2012 over the consideration transferred.

<sup>(2)</sup> We recorded a total provision for mortgage repurchase losses of \$180 million and \$37 million for the three months ended June 30, 2012 and 2011, respectively, and \$349 million and \$81 million for the six months ended June 30, 2012 and 2011, respectively. The remaining portion of the provision for repurchase losses is included, net of tax, in discontinued operations.

Non-interest income of \$1.1 billion for the second quarter of 2012 increased by \$197 million, or 23%, from non-interest income of \$857 million for the second quarter of 2011. The increase was largely attributable to increased fees resulting from continued growth and market share from new account originations and our recent acquisitions. The partial quarter impact of the acquired HSBC U.S. card operations represented approximately \$163 million of the increase in non-interest income. The increase in fees was partially offset by additional expense of \$41 million recorded in the second quarter of 2012 for expected customer refunds related to regulatory settlements pertaining to cross-sell activities in our Domestic Card business and an increase in the provision for mortgage repurchase losses.

Non-interest income of \$2.6 billion for the first six months of 2012 increased by \$776 million, or 43%, from non-interest income of \$1.8 billion for the first six months of 2011. This increase reflected the combined impact of the bargain purchase gain of \$594 million recognized in the first quarter of 2012 at acquisition of ING Direct,



**Table of Contents**

income of \$162 million recorded in the first quarter of 2012 from the sale of Visa stock shares, and the increased fees resulting from continued growth and market share from new account originations, due in part to our recent acquisitions. The favorable impact of these items was partially offset by cross-sell activities related to expected customer refunds of approximately \$116 million recorded in the first six months of 2012, a mark-to-market derivative loss of \$78 million recognized in the first quarter of 2012 related to the settlement of interest-rate swaps we entered into in 2011 to partially hedge the interest rate risk of the net assets associated with the ING Direct acquisition and an increase in the provision for mortgage repurchase losses.

We also recorded higher other-than-temporary impairment losses of \$13 million and \$27 million in the second quarter and first six months of 2012, respectively, compared with \$6 million and \$9 million in the second quarter and first six months of 2011, respectively. The impairment losses stemmed from deterioration in the credit quality of certain non-agency mortgage-backed securities due to the persistent weakness in the housing market. We provide additional information on other-than-temporary impairment recognized on our available-for-sale securities in Note 4 Investment Securities.

**Provision for Credit Losses**

We build our allowance for loan and lease losses and unfunded lending commitment reserves through the provision for credit losses. Our provision for credit losses in each period is driven by charge-offs and the level of allowance for loan and lease losses that we determine is necessary to provide for probable credit losses inherent in our loan portfolio as of each balance sheet date.

We recorded a provision for credit losses of \$1.7 billion and \$2.3 billion in the second quarter and first six months of 2012, respectively, compared with \$343 million and \$877 million in the second quarter and first six months of 2011, respectively. The significant increase in our provision for credit losses was primarily related to the addition of the \$26.2 billion in outstanding HSBC U.S. card loans designated as held for investment that had existing revolving privileges at acquisition. These loans were recorded at a fair value of \$26.9 billion, resulting in a net premium of \$705 million at acquisition. Fair value was determined by discounting all expected cash flows (contractual principal, interest, finance charges and fees of \$33.3 billion less those amounts not expected to be collected of \$3.0 billion) at a market discount rate.

Under applicable accounting guidance, we are required to amortize the net premium of \$705 million over the contractual principal amount as an adjustment to interest income over the remaining life of the loans. Given the guidance applicable to revolving loans, it is necessary to record an allowance through provision expense to properly recognize an estimate of incurred losses on the existing principal balances, which represents a portion of the total amounts not expected to be collected described above. In the second quarter of 2012, we recorded provision expense of \$1.2 billion to establish an allowance primarily related to these loans. The allowance was calculated using the same methodology utilized for determining the allowance for our existing credit card loan portfolio. The provision expense of \$1.2 billion is included in the total provision for credit losses of \$1.7 billion recorded in the second quarter of 2012. The provision for credit losses, excluding the allowance build related to HSBC U.S. card loans, was \$479 million and \$1.1 billion in the second quarter and first six months of 2012, respectively. The increase in the provision also reflects higher auto loan originations.

We provide additional information on the provision for credit losses and changes in the allowance for loan and lease losses under the Credit Risk Profile Summary of Allowance for Loan and Lease Losses and Note 6 Allowance for Loan and Lease Losses. For information on the allowance methodology for our credit card loan portfolio, see Note 1 Summary of Significant Accounting Policies in our 2011 Form 10-K.

**Non-Interest Expense**

Non-interest expense consists of ongoing operating costs, such as salaries and associated employee benefits, communications and other technology expenses, supplies and equipment and occupancy costs, and miscellaneous

**Table of Contents**

expenses. Marketing expenses are also included in non-interest expense. Table 6 displays the components of non-interest expense for the three and six months ended June 30, 2012 and 2011.

**Table 6: Non-Interest Expense**

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Salaries and associated benefits	\$ 971	\$ 715	\$ 1,835	\$ 1,456
Marketing	334	329	655	605
Communications and data processing	203	162	375	326
Supplies and equipment	178	124	325	259
Occupancy	145	118	268	237
Merger-related expense	133		219	
Other non-interest expense:				
Professional services	313	302	607	551
Collections	141	144	277	295
Fraud losses	37	30	78	57
Bankcard association assessments	137	103	247	185
Amortization of intangibles	158	56	218	112
Other	392	172	542	334
Total other non-interest expense	1,178	807	1,969	1,534
Total non-interest expense	\$ 3,142	\$ 2,255	\$ 5,646	\$ 4,417

Non-interest expense of \$3.1 billion for the second quarter of 2012 increased by \$887 million, or 39%, from the second quarter of 2011. The increase was primarily due to higher operating expenses and merger-related costs related to our recent acquisitions, higher infrastructure costs from our continued investments in our home loan business and growth in auto originations, and increased amortization of intangibles. Our second quarter 2012 results also reflect the unfavorable impact of charges related to certain other items, including \$60 million for civil penalties related to regulatory settlements pertaining to cross-sell activities in our Domestic Card business and \$98 million for net legal costs related to interchange and other litigation activity during the quarter.

Non-interest expense of \$5.6 billion for the first six months of 2012 increased by \$1.2 billion, or 28%, from the first six months of 2011. The increase was primarily due to higher operating expenses and merger-related costs related to our recent acquisitions, increased marketing expenditures, higher infrastructure costs from our continued investments in our home loan business and growth in auto originations, and increased amortization on intangibles. Our results for the first six months of 2012 also reflect the unfavorable impact of the \$60 million for civil penalties related to cross-sell activities and \$98 million for net legal costs related to interchange and other litigation developments discussed above.

**Income Taxes**

Our effective tax rate on income from continuing operations varies between periods due, in part, to fluctuations in our pre-tax earnings, which affect the relative tax benefit of tax-exempt income, tax credits and other tax items.

We recorded an income tax provision of \$43 million (18.2% effective income tax rate) for the second quarter of 2012, compared with an income tax provision of \$450 million (32.3 % effective income tax rate) for the second quarter of 2011. The decrease in our effective tax rate in the second quarter of 2012 was primarily due to one-time deferred tax benefit of \$25 million for changes in our state tax position resulting from the acquisition of the HSBC U.S. card assets and operations, and a net tax benefit of \$7 million related to adjustments for the resolution of certain tax issues and audits, which together reduced our effective tax rate for the second quarter of 2012 by 13.6 percentage points.

---

## **Table of Contents**

We recorded an income tax provision of \$396 million (18.9% effective income tax rate) for the first six months of 2012, compared with an income tax provision of \$804 million (28.9% effective income tax rate) for the first six months of 2011. The decrease in our effective tax rate in the first six months of 2012 was primarily due to non-taxable ING Direct bargain purchase gain of \$594 million recorded in the first quarter of 2012 at acquisition of ING Direct. In addition to the one-time deferred tax benefit discussed above, we recorded tax benefits of \$12 million in the first six months of 2012 related to the resolution of certain tax issues and audits. In comparison, we recorded tax benefits of \$45 million related to adjustments for the resolution of certain tax issues and audits in the first six months of 2011. Our effective income tax rate, excluding both the impact of the non-taxable bargain purchase gain and the benefits from these discrete tax issues and audits, was 28.9% and 30.5% in the first six months of 2012 and 2011, respectively.

We provide additional information on items affecting our income taxes and effective tax rate in our 2011 Form 10-K under Note 18 Income Taxes.

### **Loss from Discontinued Operations, Net of Tax**

Loss from discontinued operations reflects ongoing costs, which primarily consist of mortgage loan repurchase representation and warranty charges, related to the mortgage origination operations of GreenPoint's wholesale mortgage banking unit, which we closed in 2007.

We recorded a pre-tax provision for mortgage repurchase losses of \$180 million in the second quarter of 2012, of which \$154 million (\$97 million, net of tax) was included in discontinued operations, and a pre-tax provision of \$349 million in the first six months of 2012, of which \$307 million (\$194 million, net of tax) was included in discontinued operations. In comparison, we recorded a pre-tax provision for mortgage repurchase losses of \$37 million in the second quarter of 2011, of which \$33 million (\$22 million, net of tax) was included in discontinued operations, and a pre-tax provision of \$81 million in the first six months of 2011, of which \$72 million (\$51 million, net of tax) was included in discontinued operations.

The increase in the provision for repurchase losses in the second quarter and first six months of 2012 was primarily driven by updated estimates of anticipated outcomes from various litigation and threatened litigation in the insured securitization segment based on relevant factual and legal developments and an increased reserve associated with a first quarter settlement between a subsidiary and a GSE to resolve present and future claims.

We provide additional information on the provision for mortgage repurchase losses and the related reserve for potential representation and warranty claims in Consolidated Balance Sheet Analysis Potential Mortgage Representation and Warranty Liabilities.

## **BUSINESS SEGMENT FINANCIAL PERFORMANCE**

Our principal operations are currently organized into three major business segments, which are defined based on the products and services provided or the type of customer served: Credit Card, Consumer Banking and Commercial Banking. The operations of acquired businesses have been integrated into our existing business segments. Certain activities that are not part of a segment, such as management of our corporate investment portfolio and asset/liability management by our centralized Corporate Treasury group, are included in the Other category.

The results of our individual businesses, which we report on a continuing operations basis, reflect the manner in which management evaluates performance and makes decisions about funding our operations and allocating resources. Our business segment results are intended to reflect each segment as if it were a stand-alone business. We use an internal management and reporting process to derive our business segment results. Our internal management and reporting process employs various allocation methodologies, including funds transfer pricing.

## **Table of Contents**

to assign certain balance sheet assets, deposits and other liabilities and their related revenue and expenses directly or indirectly attributable to each business segment. Total interest income and net fees are directly attributable to the segment in which they are reported. The net interest income of each segment reflects the results of our funds transfer pricing process, which is primarily based on a matched maturity method that takes into consideration market rates. Our funds transfer pricing process provides a funds credit for sources of funds, such as deposits generated by our Consumer Banking and Commercial Banking businesses, and a funds charge for the use of funds by each segment. The allocation process is unique to each business segment and acquired businesses. See Note 20 Business Segments of our 2011 Form 10-K for information on the allocation methodologies used to derive our business segment results.

We may periodically change our business segments or reclassify business segment results based on modifications to our management reporting methodologies and changes in organizational alignment. In the first quarter of 2012, we re-aligned the reporting of our Commercial Banking business to reflect the operations on a product basis rather than by customer type. As a result of this re-alignment, we now report three product categories: commercial and multifamily real estate, commercial and industrial loans and small-ticket commercial real estate, which is a run-off portfolio. We previously reported four categories within our Commercial Banking business: commercial and multifamily real estate, middle market, specialty lending and small-ticket commercial real estate. Middle market and specialty lending related products are included in commercial and industrial loans. All tax-related commercial real estate investments, some of which were previously included in the Other segment, are now included in the commercial and multifamily real estate category of our Commercial Banking business. Prior period amounts have been recast to conform to the current period presentation.

We summarize our business segment results for the three and six months ended June 30, 2012 and 2011 in the tables below and provide a comparative discussion of these results. We also discuss changes in our financial condition and credit performance statistics as of June 30, 2012, compared with December 31, 2011. See Note 14 Business Segments of this Report for a reconciliation of our business segment results to our consolidated results. Information on the outlook for each of our business segments is presented above under Executive Summary and Business Outlook.

### **Credit Card Business**

Our Credit Card business recorded a net loss from continuing operations of \$297 million and net income from continuing operations of \$269 million in the second quarter and first six months of 2012, respectively, compared with net income from continuing operations of \$618 million and \$1.3 billion in the second quarter and first six months of 2011, respectively. The primary sources of revenue for our Credit Card business are interest income and non-interest income from customers and interchange fees. Expenses primarily consist of ongoing operating costs, such as salaries and associate benefits, communications and other technology expenses, supplies and equipment, occupancy costs, as well as marketing expenses.

Table 7 summarizes the financial results of our Credit Card business, which is comprised of Domestic Card, including installment loans, and International Card operations, and displays selected key metrics for the periods indicated. The closing on May 1, 2012 of the HSBC U.S. card acquisition, which added approximately \$27.8 billion in outstanding credit card receivables designated as held for investment to our Credit Card business, had a significant impact on the results of our Credit Card business for the second quarter and first six months of 2012.

**Table of Contents****Table 7: Credit Card Business Results**

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2012	2011	Change	2012	2011	Change
<b>Selected income statement data:</b>						
Net interest income	\$ 2,350	\$ 1,890	24%	\$ 4,342	\$ 3,831	13%
Non-interest income	771	619	25	1,369	1,293	6
Total net revenue <sup>(1)</sup>	3,121	2,509	24	5,711	5,124	11
Provision for credit losses	1,711	309	454	2,169	759	186
Non-interest expense	1,863	1,238	50	3,131	2,416	30
Income from continuing operations before income taxes	(453)	962	(147)	411	1,949	(79)
Income tax provision	(156)	344	(145)	142	688	(79)
Income from continuing operations, net of tax	\$ (297)	\$ 618	(148)%	\$ 269	\$ 1,261	(79)%
<b>Selected performance metrics:</b>						
Average loans held for investment	\$ 79,662	\$ 62,691	27%	\$ 71,048	\$ 61,644	15%
Average yield on loans held for investment <sup>(2)</sup>	13.42%	13.83%	(41)bps	13.86%	14.25%	(39)bps
Total net revenue margin <sup>(3)</sup>	15.67	16.01	(34)	16.08	16.62	(54)
Net charge-off rate <sup>(4)</sup>	3.13	5.06	(193)	3.57	5.59	(202)
Net charge-off rate (excluding acquired loans) <sup>(5)</sup>	3.14	5.06	(192)	3.58	5.59	(201)
Purchase volume <sup>(6)</sup>	\$ 45,228	\$ 34,226	32%	\$ 79,726	\$ 62,023	29%
(Dollars in millions)	June 30, 2012	December 31, 2011	Change			
<b>Selected period-end data:</b>						
Loans held for investment	\$ 88,914	\$ 65,075	37%			
30+ day delinquency rate <sup>(7)</sup>	2.97%	3.86%	(89)bps			
30+ day delinquency rate (excluding acquired loans) <sup>(5)</sup>	2.99%	3.86%	(87)bps			
Allowance for loan and lease losses	\$ 3,750	\$ 2,847	32%			

(1) Total net revenue was reduced by \$311 million and \$112 million for the three months ended June 30, 2012 and 2011, respectively and \$434 million and \$217 million for the six months ended June 30, 2012 and 2011, respectively, for the estimated uncollectible amount of billed finance charges and fees.

(2) Calculated by dividing annualized interest income for the period by average loans held for investment during the period.

(3) Calculated by dividing annualized total revenue for the period by average loans held for investment during the period for the specified loan category.

(4) Calculated by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.

(5) Calculation of ratio adjusted to exclude from the denominator acquired loans accounted for subsequent to acquisition based on expected cash flows to be collected. See Summary of Selected Financial Data, Credit Risk Profile and Note 5 Loans Credit Quality for additional information on the impact of acquired loans on our credit quality metrics.

(6) Consists of purchase transactions for the period, net of returns. Excludes cash advance transactions.

(7) Calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category. The 30+ day performing delinquency rate is the same as the 30+ day delinquency rate for our Credit Card business, as credit card loans remain on accrual status until the loan is charged-off.



**Table of Contents**

Key factors affecting the results of our Credit Card business for the second quarter and first six months of 2012, compared with the second quarter and first six months of 2011 included the following:

*Net Interest Income:* Net interest income increased by \$460 million, or 24%, in the second quarter of 2012 and by \$511 million, or 13%, in the first six months of 2012. The increase in each period was primarily attributable to an increase in average loans held for investment, largely due to the partial quarter impact of the addition of the \$27.8 billion in outstanding HSBC U.S. card loans classified as held for investment in the second quarter of 2012. The increase in average loans was partially offset by a decline in average loan yields, largely due to lower yields in Domestic Card resulting from the establishment of a finance charge and fee reserve for the acquired HSBC U.S. card loan portfolio and premium amortization expense related to the acquired loans.

*Non-Interest Income:* Non-interest income increased by \$152 million, or 25%, in the second quarter of 2012 and by \$76 million, or 6%, in the first six months of 2012. The increase was primarily driven by higher fees generated from the increased purchase volume and accounts associated with the HSBC U.S. card acquisition in the second quarter of 2012. The increase from fees was partially offset by charges of \$75 million and \$41 million in the first and second quarter of 2012, respectively, for expected refunds to customers affected by cross-sell activities in our Domestic Card business as well as the discontinuance of the recognition of revenue for any amounts billed for cross-sell customers affected.

*Provision for Credit Losses:* The provision for credit losses related to our Credit Card business increased by \$1.4 billion to \$1.7 billion in the second quarter of 2012 and by \$1.4 billion to \$2.2 billion in the first six months of 2012. The increase was primarily driven by provision expense of \$1.2 billion recorded in the second quarter of 2012 to build an allowance for HSBC U.S. card loans. The provision for credit losses, excluding the allowance build related to HSBC U.S. card loans, was \$513 million and \$971 million in the second quarter and first six months of 2012, respectively, an increase for each period of approximately \$200 million over the same prior year periods, reflecting a relative stabilization in credit performance improvement compared to significant credit performance improvement in the first half of 2011 that resulted in larger allowance releases than the first half of 2012.

*Non-Interest Expense:* Non-interest expense increased by \$625 million, or 50%, in the second quarter of 2012 and by \$715 million, or 30% in the first six months of 2012. The increase was largely due to the partial quarter impact of HSBC U.S. card operating expenses and expenses related to the HSBC U.S. card acquisition, including \$85 million purchased credit card relationship ( PCCR ) intangible amortization expense and merger-related expenses associated with the acquisition. Other items contributing to the increase included expense of \$60 million for regulatory fines related to cross-sell activities in the Domestic Card business, expense of \$98 million for net litigation reserves to cover interchange and other settlements reached in the second quarter of 2012

*Total Loans:* Period-end loans in our Credit Card business increased by \$23.8 billion, or 37%, to \$88.9 billion as of June 30, 2012, from \$65.1 billion as of December 31, 2011, primarily due to the addition of the \$27.8 billion in outstanding HSBC U.S. card loans classified as held of investment, which was partially offset by the continued run-off of our installment loan portfolio.

*Charge-off and Delinquency Statistics:* The net charge-off rate decreased to 3.13% and 3.57% in the second quarter and first six months of 2012, respectively, from 5.06% and 5.59% in the second quarter and first six months of 2011, respectively. The 30+ day delinquency rate decreased to 2.97% as of June 30, 2012, from 3.86% as of December 31, 2011. The decreases in the net-charge off rates and 30+ day delinquency rate was largely due to the addition of the HSBC U.S. card portfolio to the denominator in calculating our reported charge-off and delinquency rates and the lag in the impact of charge-offs related to this portfolio, which was recorded at fair value at acquisition. In addition, our reported charge-off and delinquency rates reflect the absence of charge-offs for the acquired HSBC U.S. card loans accounted for based on expected cash flows. The credit quality metrics in our Credit Card business also reflected continued credit improvement across our legacy card portfolio.

**Table of Contents****Domestic Card Business**

Domestic Card recorded a net loss from continuing operations of \$264 million and net income from continuing operations of \$251 million in the second quarter and first six months of 2012, respectively, compared with net income from continuing operations of \$642 million and \$1.3 billion in the second quarter and first six months of 2011, respectively.

Because our Domestic Card business currently accounts for the substantial majority of our Credit Card business, the key factors driving the results for this division are similar to the key factors affecting our total Credit Card business. The decrease in Domestic Card net income from continuing operations in the second quarter and first six months of 2012 compared with the second quarter and first six months of 2011 was driven by: (1) an increase in total net revenue largely due to the addition of the HSBC U.S. card portfolio, partially offset by expense for expected customer refunds related to cross-sell activities; (2) significant increase in the provision for credit losses resulting from an allowance build for the HSBC U.S. card loan portfolio; and (3) an increase in non-interest expense due to the partial quarter impact of HSBC U.S. card operating expenses, PCCR amortization expense related to the HSBC U.S. card acquisition and charges related to cross-sell activities and interchange litigation.

Table 7.1 summarizes the financial results for Domestic Card and displays selected key metrics for the periods indicated.

**Table 7.1: Domestic Card Business Results**

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2012	2011	Change	2012	2011	Change
<b>Selected income statement data:</b>						
Net interest income	\$ 2,118	\$ 1,607	32%	\$ 3,831	\$ 3,258	18%
Non-interest income	708	584	21	1,205	1,167	3
Total net revenue	2,826	2,191	29	5,036	4,425	14
Provision for credit losses	1,600	187	756	1,961	417	370
Non-interest expense	1,634	1,008	62	2,686	1,998	34
Income from continuing operations before income taxes	(408)	996	(141)	389	2,010	(81)
Income tax provision	(144)	354	(141)	138	714	(81)
Income from continuing operations, net of tax	\$ (264)	\$ 642	(141)%	\$ 251	\$ 1,296	(81)%
<b>Selected performance metrics:</b>						
Average loans held for investment	\$ 71,468	\$ 53,868	33%	\$ 62,800	\$ 52,884	19%
Average yield on loans held for investment <sup>(1)</sup>	13.33%	13.52%	(19)bps	13.67%	13.96%	(29)bps
Total net revenue margin <sup>(2)</sup>	15.82	16.27	(45)	16.04	16.73	(69)
Net charge-off rate <sup>(3)</sup>	2.86	4.74	(188)	3.32	5.45	(213)
Purchase volume <sup>(4)</sup>	\$ 41,807	\$ 31,070	35%	\$ 73,224	\$ 56,094	31%
<b>Selected period-end data:</b>						
(Dollars in millions)	June 30, 2012	December 31, 2011	Change			
Loans held for investment	\$ 80,798	\$ 56,609	43%			
30+ day delinquency rate <sup>(5)</sup>	2.79%	3.66%	(87)bps			
Allowance for loan and lease losses	\$ 3,295	\$ 2,375	39%			



**Table of Contents**

- (1) Calculated by dividing annualized interest income for the period by average loans held for investment during the period.
- (2) Calculated by dividing annualized total revenue for the period by loans held for investment during the period for the specified loan category.
- (3) Calculated by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.
- (4) Consists of purchase transactions for the period, net of returns. Excludes cash advance transactions.
- (5) Calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category. The 30+ day performing delinquency rate is the same as the 30+ day delinquency rate for our Credit Card business, as credit card loans remain on accrual status until the loan is charged-off.

***International Card Business***

Our International Card business recorded a net loss from continuing operations of \$33 million and net income of \$18 million in the second quarter and first six months of 2012, respectively, compared with a net loss from continuing operations of \$24 million and \$35 million in second quarter and first six months of 2011, respectively.

The primary driver of the \$9 million increase in net loss from continuing operations in the second quarter of 2012 from the net loss in the second quarter of 2011 was the recognition of expense of \$82 million in the second quarter of 2012 for the costs associated with refunds to U.K. customers related to retrospective regulatory requirements pertaining to Payment Protection Insurance ( PPI ) in the U.K, compared with expense of \$76 million in the second quarter of 2011.

The primary driver of the improvement in results in the first six months of 2012 compared with the first six months of 2011 was a decrease in the provision for credit losses, reflecting an allowance release of \$17 million in the first six months of 2012 due to lower net-charge offs and improvement in the credit environment in Canada and the U.K, compared with an allowance build of \$78 million in first six months of 2011. The allowance build was largely due to the addition of the Hudson s Bay Company ( HBC ) loan portfolio in 2011.

**Table of Contents**

Table 7.2 summarizes the financial results for International Card and displays selected key metrics for the periods indicated.

**Table 7.2: International Card Business Results**

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2012	2011	Change	2012	2011	Change
<b>Selected income statement data:</b>						
Net interest income	\$ 232	\$ 283	(18)%	\$ 511	\$ 573	(11)%
Non-interest income	63	35	80	164	126	30
Total net revenue	295	318	(7)	675	699	(3)
Provision for credit losses	111	122	(9)	208	342	(39)
Non-interest expense	229	230	**	445	418	6
Income from continuing operations before income taxes	(45)	(34)	(32)	22	(61)	136
Income tax provision	(12)	(10)	(20)	4	(26)	115
Income from continuing operations, net of tax	\$ (33)	\$ (24)	(38)%	\$ 18	\$ (35)	151%
<b>Selected performance metrics:</b>						
Average loans held for investment	\$ 8,194	\$ 8,823	(7)%	\$ 8,248	\$ 8,760	(6)%
Average yield on loans held for investment <sup>(1)</sup>	14.18%	15.77%	(159)bps	15.29%	16.02%	(73)bps
Revenue margin <sup>(2)</sup>	14.40	14.42	(2)	16.37	15.96	41
Net charge-off rate <sup>(3)</sup>	5.49	7.02	(153)	5.51	6.39	(88)
Purchase volume <sup>(4)</sup>	\$ 3,421	\$ 3,156	8%	\$ 6,502	\$ 5,929	10%
(Dollars in millions)	June 30,	December 31,	Change			
	2012	2011				
<b>Selected period-end data:</b>						
Loans held for investment	\$ 8,116	\$ 8,466	(4)%			
30+ day delinquency rate <sup>(5)</sup>	4.84%	5.18%	(34)bps			
Allowance for loan and lease losses	\$ 455	\$ 472	(4)%			

\*\* Change is less than one percent.

(1) Calculated by dividing annualized interest income for the period by average loans held for investment during the period.

(2) Calculated by dividing annualized total revenue for the period by loans held for investment during the period for the specified loan category.

(3) Calculated by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.

(4) Consists of purchase transactions for the period, net of returns. Excludes cash advance transactions.

(5) Calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category. The 30+ day performing delinquency rate is the same as the 30+ day delinquency rate for our Credit Card business, as credit card loans remain on accrual status until the loan is charged-off.

**Consumer Banking Business**

Our Consumer Banking business generated net income from continuing operations of \$438 million and \$662 million in the second quarter and first six months of 2012, respectively, compared with net income from continuing operations of \$287 million and \$502 million in the second quarter and first six months of 2011, respectively. The primary sources of revenue for our Consumer Banking business are net interest income from loans and deposits and non-interest income from customer fees. Expenses primarily consist of ongoing operating costs, such as salaries and associated benefits, communications and other technology expenses, supplies and equipment and occupancy costs.



**Table of Contents**

On February 17, 2012, we acquired ING Direct, and the substantial majority of the lending and retail deposit businesses acquired are reported in the Consumer Banking segment. The acquisition resulted in the addition of loans with carrying value of \$40.4 billion and deposits of \$84.4 billion at acquisition.

Table 8 summarizes the financial results of our Consumer Banking business and displays selected key metrics for the periods indicated.

**Table 8: Consumer Banking Business Results**

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2012	2011	Change	2012	2011	Change
<b>Selected income statement data:</b>						
Net interest income	\$ 1,496	\$ 1,051	42%	\$ 2,784	\$ 2,034	37%
Non-interest income	185	194	(5)	361	380	(5)
Total net revenue	1,681	1,245	35	3,145	2,414	30
Provision for credit losses	44	41	7	218	136	60
Non-interest expense	959	758	27	1,902	1,498	27
Income from continuing operations before income taxes	678	446	52	1,025	780	31
Income tax provision	240	159	51	363	278	31
Income from continuing operations, net of tax	\$ 438	\$ 287	53%	\$ 662	\$ 502	32%
<b>Selected performance metrics:</b>						
Average loans held for investment <sup>(1)</sup>						
Auto	\$ 24,487	\$ 18,753	31%	\$ 23,535	\$ 18,391	28%
Home loan	48,966	11,534	325	39,234	11,746	234
Retail banking	4,153	4,154	**	4,166	4,202	(1)
Total consumer banking	\$ 77,606	\$ 34,441	125%	\$ 66,935	\$ 34,339	95%
Average yield on loans held for investment	6.17%	9.51%	(334)bps	6.61%	9.55%	(294)bps
Average deposits	\$ 174,416	\$ 86,926	101%	\$ 152,166	\$ 85,413	78%
Average deposit interest rate	0.70%	1.00%	(30)bps	0.72%	1.03%	(31)bps
Core deposit intangible amortization	\$ 42	\$ 34	24%	\$ 79	\$ 68	16%
Net charge-off rate <sup>(2)</sup>	0.48%	1.01%	(53)bps	0.60%	1.29%	(69)bps
Net charge-off rate (excluding acquired loans) <sup>(2)</sup>	1.02%	1.17	(15)	1.15	1.50	(35)
Automobile loan originations	\$ 4,306	\$ 2,910	48%	\$ 8,576	\$ 5,481	56%

**Table of Contents**

(Dollars in millions)	June 30, 2012	December 31, 2011	Change
<b>Selected period-end data:</b>			
Loans held for investment: <sup>(1)</sup>			
Auto	\$ 25,251	\$ 21,779	16%
Home loans	48,224	10,433	362
Retail banking	4,140	4,103	1
Total consumer banking	\$ 77,615	\$ 36,315	114%
30+ day performing delinquency rate <sup>(4)</sup>	1.82%	4.47%	(265)bps
30+ day performing delinquency rate (excluding acquired loans) <sup>(3)</sup>	3.82	5.06	(124)
30+ day delinquency rate <sup>(5)</sup>	2.47	5.99	(352)
30+ day delinquency rate (excluding acquired loans) <sup>(3)</sup>	5.19	6.78	(159)
Nonperforming loan rate <sup>(6)</sup>	0.79	1.79	(100)
Nonperforming loan rate (excluding acquired loans) <sup>(3)</sup>	1.66	2.03	(37)
Nonperforming asset rate <sup>(7)</sup>	0.83	1.94	(111)
Nonperforming asset rate (excluding acquired loans) <sup>(3)</sup>	1.75	2.20	(45)
Allowance for loan and lease losses	\$ 669	\$ 652	3%
Deposits	173,966	88,540	96
Loans serviced for others	16,108	17,998	(11)

- (1) Loans held for investment includes loans acquired in the ING Direct and Chevy Chase Bank acquisitions. The carrying value of consumer banking acquired loans accounted for subsequent to acquisition based on expected cash flows to be collected was \$40.7 billion and \$4.2 billion as of June 30, 2012, and December 31, 2011, respectively. The average balance of consumer banking loans held for investment, excluding the carrying value of acquired loans, was \$36.2 billion and \$29.8 billion for the three months ended June 30, 2012 and 2011, respectively and \$35.0 billion and \$29.6 billion for the six months ended June 30, 2012 and 2011, respectively.
- (2) Calculated by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.
- (3) Calculation of ratio adjusted to exclude from the denominator acquired loans accounted for subsequent to acquisition based on expected cash flows to be collected. See Summary of Selected Financial Data, Credit Risk Profile and Note 5 Loans Credit Quality for additional information on the impact of acquired loans on our credit quality metrics.
- (4) Calculated by loan category by dividing 30+ day performing delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category.
- (5) Calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category.
- (6) Calculated by loan category by dividing nonperforming loans as of the end of the period by period-end loans held for investment for the specified loan category. Nonperforming loans generally include loans that have been placed on nonaccrual status and certain restructured loans whose contractual terms have been restructured in a manner that grants a concession to a borrower experiencing financial difficulty.
- (7) The nonperforming asset rate is calculated by loan category by dividing nonperforming assets as of the end of the period by period-end nonperforming assets. Nonperforming assets consist of nonperforming loans, real estate owned ( REO ) and other foreclosed assets.
- Key factors contributing to the improvement in the results of our Consumer Banking business for the second quarter and first six months of 2012, compared with the second quarter and first six months of 2011 included the following:

*Net Interest Income:* Net interest income increased by \$445 million, or 42%, in the second quarter of 2012 and by \$750 million, or 37%, in the first six months of 2012. The increase was primarily attributable to an increase in average loans held for investment due to higher originations in auto loans over the past twelve months as well as the acquisition of ING Direct home loans in the first quarter of 2012. The favorable impact of the increase in average loans more than offset a decline in loan yields, attributable to the lower yielding ING Direct home loan portfolio.

---

## **Table of Contents**

*Non-Interest Income:* Non-interest income decreased by \$9 million, or 5%, in the second quarter of 2012 and by \$19 million, or 5%, in the first six months of 2012. The decrease was primarily attributable to reduced revenues resulting from the implementation of the Dodd-Frank amendment related to debit interchange fees in late 2011, which was partially offset by the addition of ING Direct deposits in the first quarter of 2012.

*Provision for Credit Losses:* The provision for credit losses increased by \$3 million to \$44 million in the second quarter of 2012 and by \$82 million to \$218 million in the first six months of 2012. The increase in the provision was largely due to higher auto loan originations, which more than offset the benefit from lower net charge-offs and continued credit performance improvement.

*Non-Interest Expense:* Non-interest expense increased by \$201 million, or 27%, in the second quarter of 2012 and by \$404 million, or 27% in the first six months of 2012. The increase was largely attributable to the on-going operating expenses of ING Direct, the associated merger-related expenses for the acquisition, higher infrastructure expenditure resulting from continued investments in the home loan business and growth in auto originations.

*Total Loans:* Period-end loans held for investment in our Consumer Banking business more than doubled, increasing by \$41.3 billion to \$77.6 billion as of June 30, 2012, from \$36.3 billion as of December 31, 2011, primarily due to the acquisition of \$40.4 billion of ING Direct home loans and increased originations in auto loans, partially offset by the continued run-off of our legacy home loan portfolios.

*Deposits:* Period-end deposits in the Consumer Banking business increased by \$85.4 billion, or 96%, to \$174.0 billion as of June 30, 2012, from \$88.5 billion as of December 31, 2011, primarily due to the addition of ING Direct deposits of \$84.4 billion and a slight increase in deposits in our retail branch franchise.

*Charge-off and Delinquency Statistics:* The improvement in the reported net charge-off and delinquency rates for our Consumer Banking business reflect the impact of the addition of the ING Direct home loan portfolio, the substantial majority of which is accounted for based on estimated cash flows expected to be collected over the life of the loans. As discussed above in *Summary of Selected Financial Data*, because the fair value recorded at acquisition and subsequent accounting for these loans takes into consideration future credit losses expected to be incurred, there are no charge-offs or an allowance associated with these loans unless the estimated cash flows expected to be collected decrease subsequent to acquisition. In addition, these loans are not classified as delinquent or nonperforming even though the customer may be contractually past due because we expect that we will fully collect the carrying value of these loans. The improvement in net-charge and delinquency rates, excluding acquired loans, reflects improved credit performance in our legacy loan portfolios.

### **Commercial Banking Business**

Our Commercial Banking business generated net income from continuing operations of \$228 million and \$438 million in the second quarter and first six months of 2012, respectively, compared with net income from continuing operations of \$159 million and \$321 million in the second quarter and first six months of 2011, respectively. The primary sources of revenue for our Commercial Banking business are net interest income from loans and deposits and non-interest income from customer fees. Expenses primarily consist of ongoing operating costs, such as salaries and associated benefits, communications and other technology expenses, supplies and equipment and occupancy costs. Because we have some tax-related commercial investments that generate tax-exempt income or tax credits, we make certain reclassifications to our Commercial Banking business results to present revenues on a taxable-equivalent basis.

**Table of Contents**

Table 9 summarizes the financial results of our Commercial Banking business and displays selected key metrics for the periods indicated.

**Table 9: Commercial Banking Business Results**

(Dollars in millions)	Three Months Ended June 30,			Six Months Ended June 30,		
	2012	2011	Change	2012	2011	Change
<b>Selected income statement data:</b>						
Net interest income	\$ 427	\$ 388	10%	\$ 858	\$ 764	12%
Non-interest income	82	62	32	167	133	26
Total net revenue	509	450	13	1,025	897	14
Provision for credit losses	(94)	(19)	395	(163)	(35)	366
Non-interest expense	251	222	13	512	434	18
Income from continuing operations before income taxes	352	247	43	676	498	36
Income tax provision	124	88	41	238	177	34
Income from continuing operations, net of tax	\$ 228	\$ 159	43%	\$ 438	\$ 321	36%
<b>Selected performance metrics:</b>						
Average loans held for investment: <sup>(1)</sup>						
Commercial and multifamily real estate	\$ 15,838	\$ 13,859	14%	\$ 15,676	\$ 13,720	14%
Commercial and industrial	18,001	14,993	20	17,520	14,813	18
Total commercial lending	33,839	28,852	17	33,196	28,532	16
Small-ticket commercial real estate	1,388	1,726	(20)	1,434	1,772	(19)
Total commercial banking	\$ 35,227	\$ 30,578	15%	\$ 34,630	\$ 30,304	14%
Average yield on loans held for investment	4.27%	4.75%	(48)bps	4.37%	4.78%	(41)bps
Average deposits	\$ 27,943	\$ 24,371	15%	\$ 27,756	\$ 24,302	14%
Average deposit interest rate	0.33%	0.52%	(19)bps	0.35%	0.53%	(18)bps
Core deposit intangible amortization	\$ 9	\$ 10	(10)%	\$ 18	\$ 21	(14)%
Net charge-off rate <sup>(2)</sup>	0.19%	0.50%	(31)bps	0.19%	0.65%	(46)bps
Net charge-off rate (excluding acquired loans) <sup>(3)</sup>	0.19	0.50	(31)	0.19	0.66	(47)

**Table of Contents**

(Dollars in millions)	June 30, 2012	December 31, 2011	Change
<b>Selected period-end data:</b>			
Loans held for investment: <sup>(1)</sup>			
Commercial and multifamily real estate	\$ 16,254	\$ 15,736	3%
Commercial and industrial	18,467	17,088	8
<b>Total commercial lending</b>	<b>34,721</b>	32,824	<b>6</b>
Small-ticket commercial real estate	1,335	1,503	(11)
<b>Total commercial banking</b>	<b>\$ 36,056</b>	\$ 34,327	<b>5%</b>
Nonperforming loan rate <sup>(4)</sup>	0.99%	1.08%	(9)bps
Nonperforming loan rate (excluding acquired loans) <sup>(3)</sup>	1.00	1.10	(10)
Nonperforming asset rate <sup>(5)</sup>	1.04	1.17	(13)
Nonperforming asset rate (excluding acquired loans) <sup>(3)</sup>	1.05	1.18	(13)
Allowance for loan and lease losses	\$ 535	\$ 715	(25)%
Deposits	27,784	26,683	4

- <sup>(1)</sup> Loans held for investment includes loans acquired in the ING Direct and Chevy Chase Bank acquisitions. The carrying value of commercial banking acquired loans accounted for subsequent to acquisition based on expected cash flows to be collected was \$430 million and \$479 million as of June 30, 2012, and December 31, 2011, respectively. The average balance of commercial banking loans held for investment, excluding the carrying value of acquired loans, was \$34.8 billion and \$34.2 billion in the second quarter and first six months of 2012, respectively and \$30.1 billion and \$29.8 billion in the second quarter and first six months of 2011, respectively.
- <sup>(2)</sup> Calculated by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.
- <sup>(3)</sup> Calculation of ratio adjusted to exclude from the denominator acquired loans accounted for subsequent to acquisition based on expected cash flows to be collected. See Summary of Selected Financial Data, Credit Risk Profile and Note 5 Loans Credit Quality for additional information on the impact of acquired loans on our credit quality metrics.
- <sup>(4)</sup> Calculated by loan category by dividing nonperforming loans as of the end of the period by period-end loans held for investment for the specified loan category. Nonperforming loans generally include loans that have been placed on nonaccrual status and certain restructured loans whose contractual terms have been restructured in a manner that grants a concession to a borrower experiencing financial difficulty.
- <sup>(5)</sup> The nonperforming asset rate is calculated by loan category by dividing nonperforming assets as of the end of the period by period-end loans held for investment, REO, and other foreclosed assets for the specified loan category.

Key factors affecting the results of our Commercial Banking business for the second quarter and first six months of 2012, compared with the second quarter and first six months of 2011 included the following:

*Net Interest Income:* Net interest income increased by \$39 million, or 10%, in the second quarter of 2012 and by \$94 million, or 12%, in the first six months of 2012. The increase was primarily driven by higher deposit balances and growth in commercial real estate and commercial and industrial loans.

*Non-Interest Income:* Non-interest income increased by \$20 million, or 32% in the second quarter of 2012 and by \$34 million, or 26% in the first six months of 2012, largely attributable to growth in fees from ancillary services provided to customers.

*Provision for Credit Losses:* The provision for credit losses decreased by \$75 million to negative \$94 million in the second quarter of 2012 and decreased by \$128 million to negative \$163 million in the first six months of 2012. The significant reduction in the provision for credit losses was attributable to lower charge-offs due to an improvement in underlying credit performance trends. As a result, we recorded allowance releases of \$101 million and \$180 million in the second quarter and first six months of 2012, respectively, compared with allowance releases of \$53 million and \$98 million in the second quarter and first six months of 2011, respectively.





**Table of Contents**

*Non-Interest Expense:* Non-interest expense increased by \$29 million, or 13% in the second quarter of 2012 and by \$78 million, or 18% in the first six months of 2012. The increase was due to costs associated with higher originations in our commercial real estate and commercial and industrial businesses, expansion into new markets and infrastructure investments.

*Total Loans:* Period-end loans in the Commercial Banking business increased by \$1.7 billion, or 5%, to \$36.1 billion as of June 30, 2012, from \$34.3 billion as of December 31, 2011. The increase was driven by stronger loan originations in the commercial and industrial and commercial real estate businesses, which was partially offset by the continued run-off of the small-ticket commercial real estate loan portfolio.

*Deposits:* Period-end deposits in the Commercial Banking business increased by \$1.1 billion, or 4%, to \$27.8 billion as of June 30, 2012, from \$26.7 billion as of December 31, 2011, driven by our strategy to strengthen existing relationships and increase liquidity from commercial customers.

*Charge-off Statistics:* Credit metrics in our Commercial Banking business significantly improved in the second quarter and first six months of 2012, attributable to improving credit trends and strengthening of underlying collateral values. This improvement has resulted in lower loss severities and created opportunities for recoveries on previously charged-off loans. The net charge-off rate decreased to 0.19% in both the second quarter and first six months of 2012, from 0.50% and 0.65% in the second quarter and first six months of 2011, respectively.

**Table of Contents****CONSOLIDATED BALANCE SHEET ANALYSIS**

Total assets of \$296.6 billion as of June 30, 2012 increased by \$90.6 billion, or 44%, from \$206.0 billion as of December 31, 2011. Total liabilities of \$259.4 billion as of June 30, 2012, increased by \$83.0 billion, or 47%, from \$176.4 billion as of December 31, 2011. Stockholders equity increased by \$7.5 billion during the first six months of 2012, to \$37.2 billion as of June 30, 2012 from \$29.7 billion as of December 31, 2011. The increase in stockholders equity was primarily attributable to our net income of \$1.5 billion in the first six months of 2012, and the \$5.8 billion in equity issuances in the first six months of 2012.

Following is a discussion of material changes in the major components of our assets and liabilities during the first six months of 2012.

**Investment Securities**

Our investment securities portfolio, which had a fair value of \$55.3 billion and \$38.8 billion, as of June 30, 2012 and December 31, 2011, respectively, consists of the following: U.S. Treasury and U.S. agency debt obligations; agency and non-agency mortgage-backed securities; asset-backed securities collateralized primarily by credit card loans, auto loans, student loans, auto dealer floor plan inventory loans, equipment loans, commercial paper, and home equity lines of credit; municipal securities; foreign government/agency bonds; covered bonds; and Community Reinvestment Act ( CRA ) equity securities. Our investment securities portfolio continues to be concentrated in securities that generally have lower credit risk and high credit ratings, such as securities issued and guaranteed by the U.S. Treasury and government sponsored enterprises or agencies. Investments in U.S. Treasury, agency securities and other securities guaranteed by the U.S. Government, based on fair value, accounted for 68% of our total investment securities portfolio as of June 30, 2012, compared with 69% as of December 31, 2011.

All of our investment securities were classified as available for sale as of June 30, 2012 and reported in our consolidated balance sheet at fair value. Table 10 presents the amortized cost and fair value for the major categories of our investment securities as of June 30, 2012 and December 31, 2011.

**Table 10: Investment Securities**

(Dollars in millions)	June 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Treasury debt obligations	\$ 1,559	\$ 1,562	\$ 115	\$ 124
U.S. agency debt obligations <sup>(1)</sup>	381	388	131	138
Residential mortgage-backed securities ( RMBS ):				
Agency <sup>(2)</sup>	30,013	30,616	24,980	25,488
Non-agency	3,800	3,671	1,340	1,162
Total RMBS	33,813	34,287	26,320	26,650
Commercial mortgage-backed securities ( CMBS ):				
Agency <sup>(2)</sup>	4,740	4,811	697	711
Non-agency	1,264	1,298	459	476
Total CMBSs	6,004	6,109	1,156	1,187
Other asset-backed securities <sup>(3)</sup>	11,646	11,689	10,119	10,150
Other securities <sup>(4)</sup>	1,219	1,254	462	510
Total securities available for sale	\$ 54,622	\$ 55,289	\$ 38,303	\$ 38,759

- <sup>(1)</sup> Includes debt securities issued by Fannie Mae and Freddie Mac with an amortized cost of \$130 million as of both June 30, 2012 and December 31, 2011, and fair value of \$135 million and \$137 million, as of June 30, 2012 and December 31, 2011, respectively. The remaining balance consists of debt that is guaranteed by the U.S. Government.

**Table of Contents**

- (2) Includes MBS issued by Fannie Mae, Freddie Mac and Ginnie Mae with an amortized cost of \$15.1 billion, \$10.3 billion, and \$9.4 billion and \$12.3 billion, \$8.9 billion and \$4.5 billion, respectively, as of June 30, 2012 and December 31, 2011, respectively, and fair value of \$15.4 billion, \$10.5 billion, and \$9.5 billion and \$12.6 billion, \$9.1 billion and \$4.5 billion, respectively, as of June 30, 2012 and December 31, 2011, respectively. The book value of Fannie Mae, Freddie Mac and Ginnie Mae investments individually exceeded 10% of our stockholders' equity as of June 30, 2012 and December 31, 2011.
- (3) Includes securities collateralized by credit card loans, auto dealer floor plan inventory loans and leases, auto loans, student loans, equipment loans, and other. The distribution among these asset types was approximately 73% credit card loans, 13% auto dealer floor plan inventory loans and leases, 6% auto loans, 1% student loans, 2% equipment loans, 2% commercial paper, and 3% other as of June 30, 2012. In comparison, the distribution was approximately 75% credit card loans, 11% auto dealer floor plan inventory loans and leases, 6% auto loans, 4% student loans, 2% equipment loans, and 2% other as of December 31, 2011. Approximately 85% of the securities in our asset-backed security portfolio were rated AAA or its equivalent as of June 30, 2012, compared with 86% as of December 31, 2011.
- (4) Includes foreign government/agency bonds, covered bonds, municipal securities and equity investments, primarily related to CRA activities. Our investment securities increased by \$16.5 billion, or 43%, in the first six months of 2012. The increase was primarily attributable to the acquisition of ING Direct investment securities of \$30.2 billion, which was partially offset by the sale of investment securities of approximately \$14.3 billion. We recorded a total net gain of \$41 million on the sale of these securities.

Unrealized gains and losses on our available-for-sale securities are recorded net of tax as a component of accumulated other comprehensive income (AOCI). We had gross unrealized gains of \$880 million and gross unrealized losses of \$213 million on available-for-sale securities as of June 30, 2012, compared with gross unrealized gains of \$683 million and gross unrealized losses of \$227 million on available-for-sale securities as of December 31, 2011. The substantial majority of the gross unrealized losses as of June 30, 2012 and December 31, 2011 related to non-agency residential MBS. Of the \$213 million gross unrealized losses as of June 30, 2012, \$119 million related to securities that had been in a loss position for more than 12 months.

We recognized net OTTI on investment debt securities of \$13 million and \$27 million in the second quarter and first six months of 2012. In comparison, we recognized net OTTI on investment debt securities of \$6 million and \$9 million in the second quarter and first six months of 2011, which was due in part to the deterioration in the credit performance and outlook of certain non-agency securities as a result of continued weakness in the housing market.

We provide additional information on our available-for-sale investment securities in Note 4 Investment Securities.

**Credit Ratings**

Our investment securities portfolio continues to be concentrated in securities that generally have lower credit risk and high credit ratings, such as securities issued and guaranteed by the U.S. Treasury and government sponsored enterprises or agencies. Approximately 89% and 91% of our total investment securities portfolio was rated AA+ or its equivalent, or higher, as of June 30, 2012 and December 31, 2011, respectively, while approximately 7% and 4% were below investment grade as of June 30, 2012 and December 31, 2011, respectively. We categorize the credit ratings of our investment securities based on the lowest credit rating as issued by the rating agencies S&P, Moody's Investors Service (Moody's) and Fitch Ratings (Fitch).

Table 11 provides information on the credit ratings of our non-agency residential MBS, non-agency commercial MBS and asset-backed securities, which accounted for the substantial majority of the unrealized losses related to our investment securities portfolio as of June 30, 2012 and December 31, 2011.

**Table of Contents****Table 11: Non-Agency Investment Securities Credit Ratings**

(Dollars in millions)	June 30, 2012					December 31, 2011				
	Amortized Cost	AAA	Other Investment Grade	Below Investment Grade or Not Rated		Amortized Cost	AAA	Other Investment Grade	Below Investment Grade or Not Rated	
Non-agency residential MBS	\$ 3,800	1%	6%	93%		\$ 1,340	%	3%	97%	
Non-agency commercial MBS	1,264	94	6	0		459	92	8		
Asset-backed securities	11,646	85	12	3		10,119	86	14		

**Loans Held-for-Investment**

Table 12 summarizes loans held for investment, net of the allowance for loan and lease losses, as of June 30, 2012 and December 31, 2011.

**Table 12: Net Loans Held for Investment**

(Dollars in millions)	June 30, 2012			December 31, 2011		
	Total Loans Held For Investment	Allowance	Net Loans Held For Investment	Total Loans Held For Investment	Allowance	Net Loans Held For Investment
Credit Card	\$ 88,914	\$ 3,750	\$ 85,164	\$ 65,075	\$ 2,847	\$ 62,228
Consumer Banking	77,615	669	76,946	36,315	652	35,663
Commercial Banking	36,056	535	35,521	34,327	715	33,612
Other	164	44	120	175	36	139
<b>Total</b>	<b>\$ 202,749</b>	<b>\$ 4,998</b>	<b>\$ 197,751</b>	<b>\$ 135,892</b>	<b>\$ 4,250</b>	<b>\$ 131,642</b>

Total loans held for investment increased by \$66.9 billion, or 49%, in the first six months of 2012 to \$202.7 billion as of June 30, 2012. The increase was attributable to the addition of \$40.4 billion of loans from the ING Direct acquisition and \$27.8 billion in outstanding credit card receivables classified as held for investment from the HSBC U.S. card acquisition, which was partially offset by the continued expected run-off of loans in businesses we exited or repositioned, other loan pay downs and charge-offs. The run-off portfolios include installment loans in our Credit Card business, home loans in our Consumer Banking business and small-ticket commercial real estate loans in our Commercial Banking business. We provide additional information on the composition of our loan portfolio and credit quality below in Credit Risk Profile.

**Deposits**

Our deposits have become our largest source of funding for our operations and asset growth. Total deposits increased by \$85.7 billion, or 67%, in the first six months of 2012, to \$213.9 billion as of June 30, 2012, from \$128.2 billion as of December 31, 2011. The increase in deposits reflects the addition of \$84.4 billion in deposits from the ING Direct acquisition and increased retail marketing efforts to attract new business and continued strategy to leverage our bank outlets to attract lower cost deposit funding. We provide additional information on the composition of our deposits, average outstanding balances, interest expense and yield below in Liquidity Risk Profile.

**Senior and Subordinated Notes and Other Borrowings**

Senior and subordinated notes and other borrowings decreased to \$22.3 billion as of June 30, 2012, from \$23.0 billion as of December 31, 2011. The \$768 million decrease in our debt, excluding securitized debt obligations,

## **Table of Contents**

was primarily attributable to a \$1.8 billion decrease in short-term borrowings, a decrease of \$282 million due to the maturity of outstanding senior notes, offset by the proceeds of approximately \$1.25 billion from the issuance of new senior notes. We provide additional information on our borrowings in Note 9 Deposits and Borrowings.

### **Securitized Debt Obligations**

Borrowings owed to securitization investors decreased by \$2.9 billion to \$13.6 billion as of June 30, 2012, from \$16.5 billion as of December 31, 2011. This decrease was attributable to scheduled maturities of the debt within our credit card securitization trusts.

### **Potential Mortgage Representation & Warranty Liabilities**

We acquired three subsidiaries that originated residential mortgage loans and sold them to various purchasers, including purchasers who created securitization trusts. These subsidiaries are Capital One Home Loans, which was acquired in February 2005; GreenPoint Mortgage Funding, Inc. ( GreenPoint ), which was acquired in December 2006 as part of the North Fork acquisition; and Chevy Chase Bank, which was acquired in February 2009 and subsequently merged into CONA.

We have established representation and warranty reserves for losses associated with the mortgage loans sold by each subsidiary that we consider to be both probable and reasonably estimable, including both litigation and non-litigation liabilities. These reserves are reported in our consolidated balance sheets as a component of other liabilities. The reserve setting process relies heavily on estimates, which are inherently uncertain, and requires the application of judgment. We evaluate these estimates on a quarterly basis. We build our representation and warranty reserves through the provision for repurchase losses, which we report in our consolidated statements of income as a component of non-interest income for loans originated and sold by Chevy Chase Bank and Capital One Home Loans and as a component of discontinued operations for loans originated and sold by GreenPoint. In establishing the representation and warranty reserves, we consider a variety of factors depending on the category of purchaser.

The aggregate reserves for all three subsidiaries were \$1.0 billion as of June 30, 2012, as compared with \$1.1 billion as of March 31, 2012, and \$943 million as of December 31, 2011. We recorded a total provision for repurchase losses for our representation and warranty repurchase exposure of \$180 million and \$349 million for the three and six months ended June 30, 2012, respectively, driven by updated estimates of anticipated outcomes from various litigation and threatened litigation in the insured securitization segment based on relevant factual and legal developments and an increased reserve associated with a first quarter settlement between a subsidiary and a GSE to resolve present and future repurchase claims.

During the three and six months ended June 30, 2012, we had settlements of repurchase requests totaling \$279 million and \$290 million, respectively, that were charged against the reserve. The table below summarizes changes in our representation and warranty reserves for the three and six months ended June 30, 2012 and 2011, and for full year 2011.

**Table of Contents****Table 13: Changes in Representation and Warranty Reserve**

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,		Full Year 2011
	2012	2011	2012	2011	
Representation and warranty repurchase reserve, beginning of period <sup>(1)</sup>	\$ 1,101	\$ 846	\$ 943	\$ 816	\$ 816
Provision for repurchase losses <sup>(2)</sup>	180	37	349	81	212
Net realized losses	(279)	(14)	(290)	(28)	(85)
Representation and warranty repurchase reserve, end of period <sup>(1)</sup>	\$ 1,002	\$ 869	\$ 1,002	\$ 869	\$ 943

<sup>(1)</sup> Reported in our consolidated balance sheets as a component of other liabilities.

<sup>(2)</sup> The pre-tax portion of the provision for mortgage repurchase claims recognized in our consolidated statements of income as a component of non-interest income totaled \$26 million and \$42 million for the three and six months ended June 30, 2012, respectively, and \$4 million and \$9 million for the three and six months ended June 30, 2011, respectively. The pre-tax portion of the provision for mortgage repurchase claims recognized in our consolidated statements of income as a component of discontinued operations totaled \$154 million and \$307 million for the three and six months ended June 30, 2012, respectively, and \$33 million and \$72 million for the three and six months ended June 30, 2011, respectively.

We provide additional information related to the representation and warranty reserve, including factors that may impact the adequacy of the reserves and the ultimate amount of losses incurred by our subsidiaries, in Note 15 Commitments, Contingencies and Guarantees.

**OFF-BALANCE SHEET ARRANGEMENTS AND VARIABLE INTEREST ENTITIES**

In the ordinary course of business, we are involved in various types of arrangements with limited liability companies, partnerships or trusts that often involve special purpose entities and variable interest entities ( VIEs ). Some of these arrangements are not recorded on our consolidated balance sheets or may be recorded in amounts different from the full contract or notional amount of the arrangements, depending on the nature or structure of, and accounting required to be applied to, the arrangement. These arrangements may expose us to potential losses in excess of the amounts recorded in the consolidated balance sheets. Our involvement in these arrangements can take many forms, including securitization and servicing activities, the purchase or sale of mortgage-backed or other asset-backed securities in connection with our home loan portfolio and loans to VIEs that hold debt, equity, real estate or other assets.

Our continuing involvement in unconsolidated VIEs primarily consists of certain mortgage loan trusts and community reinvestment and development entities. The carrying amount of assets and liabilities of these unconsolidated VIEs was \$2.6 billion and \$414 million, respectively, as of June 30, 2012, and our maximum exposure to loss was \$2.7 billion. We provide a discussion of our activities related to these VIEs in Note 7 Variable Interest Entities and Securitizations.

**CAPITAL MANAGEMENT**



The level and composition of our equity capital are determined by multiple factors, including our consolidated regulatory capital requirements and an internal risk-based capital assessment, and may also be influenced by rating agency guidelines, subsidiary capital requirements, the business environment, conditions in the financial markets and assessments of potential future losses due to adverse changes in our business and market environments.

**Capital Standards and Prompt Corrective Action**

Bank holding companies and national banks are subject to capital adequacy standards adopted by the Federal Reserve and the Office of the Comptroller of the Currency ( OCC ), respectively. The capital adequacy

**Table of Contents**

standards set forth minimum risk-based and leverage capital requirements that are based on quantitative and qualitative measures of their assets and off-balance sheet items. Under the capital adequacy standards, bank holding companies and banks currently are required to maintain a total risk-based capital ratio of at least 8%, a Tier 1 risk-based capital ratio of at least 4%, and a Tier 1 leverage capital ratio of at least 4% (3% for banks that meet certain specified criteria, including excellent asset quality, high liquidity, low interest rate exposure and the highest regulatory rating) in order to be considered adequately capitalized.

National banks also are subject to prompt corrective action capital regulations. Under prompt corrective action regulations, a bank is considered to be well capitalized if it maintains a Tier 1 risk-based capital ratio of at least 6% (200 basis points higher than the above minimum capital standard), a total risk-based capital ratio of at least 10% (200 basis points higher than the above minimum capital standard), a Tier 1 leverage capital ratio of at least 5% and is not subject to any supervisory agreement, order or directive to meet and maintain a specific capital level for any capital reserve. A bank is considered to be adequately capitalized if it meets these minimum capital ratios and does not otherwise meet the well capitalized definition. Currently, prompt corrective action capital requirements do not apply to bank holding companies. We also disclose Tier 1 common ratios, which are regulatory capital measures widely used by investors, analysts, rating agencies and bank regulatory agencies to assess the capital position of financial services companies. There is currently no mandated minimum or well capitalized standard for Tier 1 common; instead the risk-based capital rules state that voting common stockholders' equity should be the dominant element within Tier 1 common capital. While these regulatory capital measures are widely used by investors, analysts and bank regulatory agencies to assess the capital position of financial services companies, they may not be comparable to similarly titled measures reported by other companies. As discussed below, the joint regulators have recently released proposed capital regulations that will revise the prompt corrective action capital requirements and establish a minimum standard for the Tier 1 common ratio.

Table 14 provides a comparison of our capital ratios under the Federal Reserve's capital adequacy standards; and the capital ratios of the Banks and ING Bank, fsb under the OCC's capital adequacy standards as of June 30, 2012 and December 31, 2011. Table 15 provides the details of the calculation of our capital ratios.

**Table 14: Capital Ratios Under Basel I<sup>(1)</sup>**

(Dollars in millions)	Capital Ratio	June 30, 2012 <sup>(2)</sup>		December 31, 2011		
		Minimum Capital Adequacy	Well Capitalized	Capital Ratio	Minimum Capital Adequacy	Well Capitalized
<b>Capital One Financial Corp<sup>(3)</sup></b>						
Tier 1 common <sup>(4)</sup>	9.9%	N/A	N/A	9.7%	N/A	N/A
Tier 1 risk-based capital <sup>(5)</sup>	11.6	4.0%	6.0%	12.0	4.0%	6.0%
Total risk-based capital <sup>(6)</sup>	14.0	8.0	10.0	14.9	8.0	10.0
Tier 1 leverage <sup>(7)</sup>	9.0	4.0	N/A	10.1	4.0	N/A
<b>Capital One Bank (USA) N.A.</b>						
Tier 1 risk-based capital	11.0%	4.0%	6.0%	11.2%	4.0%	6.0%
Total risk-based capital	14.5	8.0	10.0	15.0	8.0	10.0
Tier 1 leverage	10.2	4.0	5.0	10.2	4.0	5.0
<b>Capital One, N.A.</b>						
Tier 1 risk-based capital	11.8%	4.0%	6.0%	11.0%	4.0%	6.0%
Total risk-based capital	13.1	8.0	10.0	12.2	8.0	10.0
Tier 1 leverage	10.4	4.0	5.0	8.7	4.0	5.0
<b>ING Bank, fsb</b>						
Tier 1 risk-based capital	26.5%	4.0%	6.0%	N/A	N/A	N/A
Total risk-based capital	26.5	8.0	10.0	N/A	N/A	N/A
Tier 1 leverage	9.4	4.0	5.0	N/A	N/A	N/A

**Table of Contents**

- (1) Calculated under capital standards and regulations based on the international capital framework commonly known as Basel I. Capital ratios that are not applicable are denoted by N/A.
- (2) Regulatory capital ratios as of June 30, 2012 are preliminary and therefore subject to change.
- (3) The regulatory framework for prompt corrective action does not apply to Capital One Financial Corp. because it is a bank holding company.
- (4) Tier 1 common ratio is a regulatory capital measure calculated based on Tier 1 common capital divided by risk-weighted assets.
- (5) Calculated based on Tier 1 risk-based capital divided by risk-weighted assets.
- (6) Calculated based on total risk-based capital divided by risk-weighted assets.
- (7) Calculated based on Tier 1 capital divided by quarterly average total assets, after certain adjustments.

We exceeded minimum capital requirements and met the well capitalized ratio levels for total risk-based capital and Tier 1 risk-based capital under Federal Reserve rules for bank holding companies as of June 30, 2012 and December 31, 2011. The Banks and ING Bank, fsb also exceeded minimum regulatory requirements under the OCC's applicable capital adequacy guidelines and were well capitalized under prompt corrective action requirements as of June 30, 2012 and December 31, 2011.

**Table 15: Risk-Based Capital Components Under Basel I<sup>(1)</sup>**

(Dollars in millions)	June 30, 2012 <sup>(2)</sup>	December 31, 2011
Total stockholders' equity	\$ 37,192	\$ 29,666
Less: Net unrealized gains recorded in AOCI <sup>(3)</sup>	(422)	(289)
Net losses on cash flow hedges recorded in AOCI <sup>(3)</sup>	34	71
Disallowed goodwill and other intangible assets <sup>(4)</sup>	(14,563)	(13,855)
Disallowed deferred tax assets	(758)	(534)
Other	(12)	(2)
<b>Tier 1 common capital</b>	<b>21,471</b>	<b>15,057</b>
Plus: Tier 1 restricted core capital items <sup>(5)</sup>	<b>3,636</b>	<b>3,635</b>
<b>Tier 1 risk-based capital</b>	<b>25,107</b>	<b>18,692</b>
Plus: Long-term debt qualifying as Tier 2 capital	<b>2,318</b>	<b>2,438</b>
Qualifying allowance for loan and lease losses	<b>2,740</b>	<b>1,979</b>
Other Tier 2 components	<b>15</b>	<b>23</b>
<b>Tier 2 risk-based capital</b>	<b>5,073</b>	<b>4,440</b>
<b>Total risk-based capital</b>	<b>\$ 30,180</b>	<b>\$ 23,132</b>
<b>Risk-weighted assets<sup>(6)</sup></b>	<b>\$ 216,341</b>	<b>\$ 155,657</b>

(1) Calculated under capital standards and regulations based on the international capital framework commonly known as Basel I.

(2) Regulatory capital ratios as of June 30, 2012 are preliminary and therefore subject to change.

(3) Amounts presented are net of tax.

(4) Disallowed goodwill and other intangible assets are net of related deferred tax liability.

(5) Consists primarily of trust preferred securities.

(6) Under regulatory guidelines for risk-based capital, on-balance sheet assets and credit equivalent amounts of derivatives and off-balance sheet items are assigned to one of several broad risk categories according to the obligor or, if relevant, the guarantor or the nature of any collateral. The aggregate dollar amount in each risk category is then multiplied by the risk weight associated with that category. The resulting weighted values from each of the risk categories are aggregated for determining total risk-weighted assets.

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Under the Dodd-Frank Act, many trust preferred securities will cease to qualify for Tier 1 capital, subject to a three year phase-out period expected to begin in 2013.

## **Table of Contents**

In November 2011, the Federal Reserve finalized capital planning rules applicable to large bank holding companies like us (commonly referred to as Comprehensive Capital Analysis and Review or CCAR). Under the rules, bank holding companies with consolidated assets of \$50.0 billion or more must submit capital plans to the Federal Reserve on an annual basis and must obtain approval from the Federal Reserve before making most capital distributions. The purpose of the rules is to ensure that large bank holding companies have robust, forward-looking capital planning processes that account for their unique risks and capital needs to continue operations through times of economic and financial stress. As part of its evaluation of a capital plan, the Federal Reserve will consider the comprehensiveness of the plan, the reasonableness of assumptions and analysis and methodologies used to assess capital adequacy and the ability of the bank holding company to maintain capital above each minimum regulatory capital ratio and above a Tier 1 common ratio of 5% on a pro forma basis under expected and stressful conditions throughout a planning horizon of at least nine quarters.

In January 2012, we submitted our capital plan to the Board of Governors of the Federal Reserve as part of the 2012 Comprehensive Capital Analysis and Review. On March 13, 2012, we were informed that the Federal Reserve had no objection to the capital actions contained in our capital plan submitted under CCAR.

### **Dividend Policy**

The declaration and payment of dividends to our stockholders, as well as the amount thereof, are subject to the discretion of our Board of Directors and will depend upon our results of operations, financial condition, capital levels, cash requirements, future prospects and other factors deemed relevant by the Board of Directors. As a bank holding company, our ability to pay dividends is largely dependent upon the receipt of dividends or other payments from our subsidiaries. We provide additional information on our dividend policy in our 2011 Form 10-K under Part I Item 1. Business Supervision and Regulation Dividends, Stock Purchases and Transfer of Funds.

Regulatory restrictions exist that limit the ability of the Banks and ING Bank, fsb to transfer funds to our bank holding company. Funds available for dividend payments from COBNA, CONA and ING Bank, fsb based on the Earnings Limitation Test were \$3.0 billion, \$697 million and \$480 million, respectively, as of June 30, 2012. Although funds are available for dividend payments from the Banks, we would execute a dividend from the Banks in consultation with the OCC. Applicable provisions that may be contained in our borrowing agreements or the borrowing agreements of our subsidiaries may limit our subsidiaries' ability to pay dividends to us or our ability to pay dividends to our stockholders. There can be no assurance that we will declare and pay any dividends.

### **Equity and Debt Offering**

On March 20, 2012 we closed a public offering of 24,442,706 shares of our common stock which we sold to the underwriters at a per share price of \$51.14 for net proceeds of approximately \$1.25 billion. In addition, we issued \$1.25 billion of our senior notes due 2015 in a public offering which closed on March 23, 2012. We used the net proceeds of these offerings, along with cash sourced from current liquidity, to fund the net consideration payable of \$31.1 billion in connection with the May 1, 2012 acquisition of HSBC's U.S credit card business.

## **RISK MANAGEMENT**

### **Overview**

Risk management is an important part of our business model, as all financial institutions are exposed to a variety of business risks that can significantly affect their financial performance. Our business activities expose us to eight major categories of risks: strategic risk, reputational risk, compliance risk, legal risk, liquidity risk, credit risk, market risk and operational risk.

## **Table of Contents**

Our risk management framework is intended to identify, assess and mitigate risks that affect or have the potential to affect our business. We target financial returns that compensate us for the amount of risk that we take and avoid excessive risk-taking. Our risk management framework consists of five key risk management principles:

Individual businesses take and manage risk within established tolerance levels in pursuit of strategic, financial and other business objectives.

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

The Board of Directors and senior management review our aggregate risk position, establish the risk appetite and work with management to ensure conformance to policy and adherence to our adopted mitigation strategy.

We employ a top risk identification system to maintain the appropriate focus on the risks and issues that may have the most impact and to identify emerging risks of consequence.

Independent assurance functions, such as our Internal Audit and Credit Review teams, assess the governance framework and test transactions, business processes and procedures to provide assurance as to whether our risk programs are operating as intended. We provide additional information on our risk management principles, roles and responsibilities, risk framework and risk appetite under MD&A Risk Management in our 2011 Form 10-K.

## **CREDIT RISK PROFILE**

Our loan portfolio accounts for the substantial majority of our credit risk exposure. Below we provide information about the composition of our loan portfolio, key concentrations and credit performance metrics.

We also engage in certain non-lending activities that may give rise to credit and counterparty settlement risk, including the purchase of securities for our investment securities portfolio, entering into derivative transactions to manage our market risk exposure and to accommodate customers, foreign exchange transactions and deposit overdrafts. We provide additional information on credit risk related to our investment securities portfolio under Consolidated Balance Sheet Analysis Investment Securities and credit risk related to derivative transactions in Note 10 Derivative Instruments and Hedging Activities.

### **Loan Portfolio Composition**

We provide a variety of lending products. Our primary products include credit cards, auto loans, home loans and commercial loans. For information on our lending policies and procedures, including our underwriting criteria, for our primary loan products, see MD&A Credit Risk Profile in our 2011 Form 10-K.

Total loans that we manage consist of held-for-investment loans recorded on our balance sheet and loans held in our securitization trusts. Loans underlying our securitization trusts are reported on our consolidated balance sheets under restricted loans for securitization investors. Table 16 presents the composition of our total held-for-investment loan portfolio, by business segments, as of June 30, 2012 and December 31, 2011.

Table 16 also displays acquired loans accounted for based on estimated cash flows expected to be collected, which consists of a limited portion of the credit card loans acquired in the HSBC transaction and the substantial majority of consumer and commercial loans acquired in the ING Direct and Chevy Chase Bank acquisitions. See the discussion of Acquired Loans below in this section.

**Table of Contents****Table 16: Loan Portfolio Composition**

(Dollars in millions)	June 30, 2012				December 31, 2011			
	Loans	Acquired Loans <sup>(1)</sup>	Total	% of Total	Loans	Acquired Loans <sup>(1)</sup>	Total	% of Total
<b>Credit Card business:</b>								
Credit card loans:								
Domestic credit card loans	\$ 79,026	\$ 504	\$ 79,530	39.2%	\$ 54,682	\$ 54,682	\$ 54,682	40.3%
International credit card loans	8,116		8,116	4.0	8,466		8,466	6.2
<b>Total credit card loans</b>	<b>87,142</b>	<b>504</b>	<b>87,646</b>	<b>43.2</b>	<b>63,148</b>		<b>63,148</b>	<b>46.5</b>
Installment loans:								
Domestic installment loans	1,243	25	1,268	0.6	1,927		1,927	1.4
<b>Total installment loans</b>	<b>1,243</b>	<b>25</b>	<b>1,268</b>	<b>0.6</b>	<b>1,927</b>		<b>1,927</b>	<b>1.4</b>
<b>Total credit card</b>	<b>88,385</b>	<b>529</b>	<b>88,914</b>	<b>43.8</b>	<b>65,075</b>		<b>65,075</b>	<b>47.9</b>
<b>Consumer Banking business:</b>								
Automobile	25,221	30	25,251	12.5	21,732	47	21,779	16.0
Home loan	7,582	40,642	48,224	23.8	6,321	4,112	10,433	7.7
Other retail	4,099	41	4,140	2.0	4,058	45	4,103	3.0
<b>Total consumer banking</b>	<b>36,902</b>	<b>40,713</b>	<b>77,615</b>	<b>38.3</b>	<b>32,111</b>	<b>4,204</b>	<b>36,315</b>	<b>26.7</b>
<b>Commercial Banking business:</b>								
Commercial and multifamily real estate	16,064	190	16,254	8.0	15,573	163	15,736	11.6
Commercial and industrial	18,226	241	18,467	9.1	16,770	318	17,088	12.6
<b>Total commercial lending<sup>(2)</sup></b>	<b>34,290</b>	<b>431</b>	<b>34,721</b>	<b>17.1</b>	<b>32,343</b>	<b>481</b>	<b>32,824</b>	<b>24.2</b>
Small-ticket commercial real estate	1,335		1,335	0.7	1,503		1,503	1.1
<b>Total commercial banking</b>	<b>35,625</b>	<b>431</b>	<b>36,056</b>	<b>17.8</b>	<b>33,846</b>	<b>481</b>	<b>34,327</b>	<b>25.3</b>
<b>Other:</b>								
Other loans	164		164	0.1	175		175	0.1
<b>Total loans held for investment</b>	<b>\$ 161,076</b>	<b>41,673</b>	<b>\$ 202,749</b>	<b>100.0%</b>	<b>\$ 131,207</b>	<b>\$ 4,685</b>	<b>\$ 135,892</b>	<b>100.0%</b>

<sup>(1)</sup> Consists of acquired loans accounted for based on estimated cash flows expected to be collected. See Note 5 Loans for additional information.

<sup>(2)</sup> Includes construction and land development loans totaling \$2.3 billion and \$2.2 billion as of June 30, 2012 and December 31, 2011, respectively.

**Credit Risk Measurement**

We closely monitor economic conditions and loan performance trends to manage and evaluate our exposure to credit risk. Trends in delinquency ratios are an indicator, among other considerations, of credit risk within our loan portfolios. The level of nonperforming assets represents another indicator of the potential for future credit losses. Accordingly, key metrics we track and use in evaluating the credit quality of our loan portfolio



## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

include delinquency and nonperforming asset rates, as well as charge-off rates and our internal risk ratings of larger balance, commercial loans. The improvements we have experienced in our credit trends across all of our businesses are stabilizing, and our credit performance is increasingly driven by seasonal trends.

We present information in the section below on the credit performance of our loan portfolio, including the key metrics we use in tracking changes in the credit quality of our loan portfolio. Loans acquired as part of the HSBC

**Table of Contents**

U.S. card, ING Direct and CCB acquisitions are included in the denominator used in calculating the credit quality metrics presented below. Because some of these acquired loans are accounted for based on expected cash flows to be collected, which takes into consideration future credit losses expected to be incurred, there are no charge-offs or an allowance associated with these loans unless the estimated cash flows expected to be collected decrease subsequent to acquisition. In addition, these loans are not classified as delinquent or nonperforming even though the customer may be contractually past due because we expect that we will fully collect the carrying value of these loans. The accounting and classification of these loans may significantly alter some of our reported credit quality metrics. We therefore supplement certain reported credit quality metrics with metrics adjusted to exclude the impact of these acquired loans.

See Note 5 Loans in this report for additional credit quality information. See Note 1 Summary of Significant Accounting Policies in our 2011 Form 10-K for information on our accounting policies for delinquent, nonperforming loans, charge-offs and TDRs for each of our loan categories.

***Delinquency Rates***

Table 17 compares 30+ day performing and total 30+ day delinquency rates, by loan category, as of June 30, 2012 and December 31, 2011. Table 17 also presents these metrics, adjusted to exclude from the denominator acquired loans accounted for based on estimated cash flows expected to be collected over the life of the loans.

Our 30+ day delinquency metrics include all held for investment loans that are 30 or more days past due, whereas our 30+ day performing delinquency metrics include loans that are 30 or more days past due and that are also currently classified as performing and accruing interest. The 30+ day delinquency and 30+ day performing delinquency metrics are the same for credit card loans, as we continue to classify credit card loans as performing until they are charged-off, generally when the loan is 180 days past due. However, the 30+ day delinquency and 30+ day performing delinquency metrics differ for other loan categories based on our policies for classifying loans as nonperforming.

**Table of Contents****Table 17: 30+ Day Delinquencies**

(Dollars in millions)	June 30, 2012						December 31, 2011					
	30+ Day Performing			30+ Day Total			30+ Day Performing			30+ Day Total		
	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>
<b>Credit Card business:</b>												
Domestic credit card and installment loans	\$ 2,252	2.79%	2.81%	\$ 2,252	2.79%	2.81%	\$ 2,073	3.66%	3.66%	\$ 2,073	3.66%	3.66%
International credit card	392	4.84	4.84	392	4.84	4.84	438	5.18	5.18	438	5.18	5.17
Total credit card	2,644	2.97	2.99	2,644	2.97	2.99	2,511	3.86	3.86	2,511	3.86	3.86
<b>Consumer Banking business:</b>												
Automobile	1,312	5.20	5.20	1,401	5.55	5.55	1,498	6.88	6.90	1,604	7.36	7.38
Home loan	70	0.15	0.93	428	0.89	5.64	93	0.89	1.47	478	4.58	7.56
Retail banking	29	0.69	0.70	87	2.10	2.12	34	0.83	0.84	94	2.29	2.32
Total consumer banking	1,411	1.82	3.82	1,916	2.47	5.19	1,625	4.47	5.06	2,176	5.99	6.78
<b>Commercial Banking business:</b>												
Commercial and multifamily real estate	41	0.25	0.25	187	1.15	1.16	217	1.38	1.40	342	2.17	2.20
Commercial and industrial	17	0.09	0.10	80	0.43	0.44	78	0.45	0.46	152	0.89	0.91
Total commercial lending	58	0.17	0.17	267	0.77	0.78	295	0.91	0.91	494	1.50	1.53
Small-ticket commercial real estate	39	2.87	2.87	51	3.82	3.82	104	6.94	6.94	141	9.38	9.38
Total commercial banking	97	0.27	0.27	318	0.88	0.89	399	1.16	1.18	635	1.85	1.88
<b>Other:</b>												
Other loans	17	10.36	10.36	51	31.10	31.10	17	9.65	9.65	46	26.29	26.29
Total	\$ 4,169	2.06%	2.59%	\$ 4,929	2.43%	3.06%	\$ 4,552	3.35%	3.47%	\$ 5,368	3.95%	4.09%

(1) Calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category, including acquired loans as applicable.

(2) Calculated by excluding acquired loans from the denominator.



**Table of Contents**

Table 18 presents an aging of 30+ day delinquent loans included in the above table.

**Table 18: Aging and Geography of 30+ Day Delinquent Loans**

(Dollars in millions)	June 30, 2012		December 31, 2011	
	Amount	% of Total Loans <sup>(1)</sup>	Amount	% of Total Loans <sup>(1)</sup>
Total loan portfolio	\$ 202,749	100.00%	\$ 135,892	100.00%
Delinquency status:				
30 - 59 days	\$ 2,102	1.04%	\$ 2,306	1.70%
60 - 89 days	1,060	0.52	1,092	0.80
90 + days	1,767	0.87	1,970	1.45
Total	\$ 4,929	2.43%	\$ 5,368	3.95%
Geographic region:				
Domestic	\$ 4,537	2.24%	\$ 4,930	3.63%
International	392	0.19	438	0.32
Total	\$ 4,929	2.43%	\$ 5,368	3.95%

<sup>(1)</sup> Calculated by dividing loans in each delinquency status category or geographic region as of the end of the period by the total held-for-investment loan portfolio, including acquired loans.

Table 19 summarizes loans that were 90 days or more past due as to interest or principal and still accruing interest as of June 30, 2012 and December 31, 2011. These loans consist primarily of credit card accounts between 90 days and 179 days past due. As permitted by regulatory guidance issued by the Federal Financial Institutions Examination Council ( FFIEC ), we continue to accrue interest on credit card loans through the date of charge-off, typically in the period the account becomes 180 days past due. While credit card loans remain on accrual status until the loan is charged-off, we establish a reserve for finance charges and fees billed but not expected to be collected and exclude this amount from revenue.

**Table 19: 90+ Days Delinquent Loans Accruing Interest**

(Dollars in millions)	June 30, 2012		December 31, 2011	
	Amount	% of Total Loans	Amount	% of Total Loans
Loan category: <sup>(1)</sup>				
Credit card <sup>(2)</sup>	\$ 1,056	1.19%	\$ 1,196	1.84%
Consumer	2	0.00	5	0.01
Commercial	16	0.04	41	0.12
Total	\$ 1,074	0.53%	\$ 1,242	0.91%
Geographic region: <sup>(3)</sup>				
Domestic	\$ 899	0.44%	\$ 1,047	0.77%
International	175	0.09	195	0.14
Total	\$ 1,074	0.53%	\$ 1,242	0.91%

- (1) Delinquency rates are calculated by loan category by dividing 90+ day delinquent loans accruing interest as of the end of the period by period-end loans held for investment for the specified loan category, including acquired loans as applicable.
- (2) Includes credit card loans that continue to accrue finance charges and fees until charged-off at 180 days. The amounts reported for credit card loans are net of billed finance charges and fees that we do not expect to collect. The estimated uncollectible portion of billed finance charges and fees excluded from revenue totaled \$311 million and \$112 million in the second quarter of 2012 and 2011, respectively and \$434 million and \$217 million in the first six months of 2012 and

**Table of Contents**

2011, respectively. The reserve for uncollectible billed finance charges and fees totaled \$268 million as of June 30, 2012, and \$74 million as of December 31, 2011.

<sup>(3)</sup> Calculated by dividing loans in each geographic region as of the end of the period by the total loan portfolio.

**Nonperforming Assets**

Nonperforming assets consist of nonperforming loans and foreclosed property and repossessed assets. Nonperforming loans generally include loans that have been placed on nonaccrual status and certain restructured loans whose contractual terms have been restructured in a manner that grants a concession to a borrower experiencing financial difficulty. We do not report loans held for sale as nonperforming. In addition, we separately track and report acquired loans and disclose our delinquency and nonperforming loan rates with and without acquired loans.

Table 20 presents comparative information on nonperforming loans, by loan category, and other nonperforming assets as of June 30, 2012 and December 31, 2011. Nonperforming loans held for sale are excluded from nonperforming loans, as they are recorded at lower of cost or fair value.

**Table 20: Nonperforming Loans and Other Nonperforming Assets<sup>(1) (2)</sup>**

(Dollars in millions)	June 30, 2012 <sup>(3)</sup>		December 31, 2011	
	Amount	% of Total HFI Loans	Amount	% of Total HFI Loans
<b>Nonperforming loans held for investment:</b>				
Consumer Banking business:				
Automobile	\$ 89	0.35%	\$ 106	0.48%
Home loan	439	0.91	456	4.37
Retail banking	86	2.09	90	2.18
Total consumer banking	614	0.79	652	1.79
Commercial Banking business:				
Commercial and multifamily real estate	200	1.23	207	1.32
Commercial and industrial	140	0.76	125	0.73
Total commercial lending	340	0.98	332	1.01
Small-ticket commercial real estate	16	1.15	40	2.63
Total commercial banking	356	0.99	372	1.08
Other:				
Other loans	40	24.59	35	20.42
Total nonperforming loans held for investment <sup>(4)</sup>	\$ 1,010	0.50%	\$ 1,059	0.78%
<b>Other nonperforming assets:</b>				
Foreclosed property <sup>(5)</sup>	\$ 232	0.11%	\$ 169	0.13%
Repossessed assets	15	0.01	20	0.01
Total other nonperforming assets	247	0.12	189	0.14
Total nonperforming assets	\$ 1,257	0.62%	\$ 1,248	0.92%

<sup>(1)</sup> The ratio of nonperforming loans as a percentage of total loans held for investment is calculated based on the nonperforming loans in each loan category divided by the total outstanding unpaid principal balance of loans held for investment in each loan category. The denominator

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

used in calculating the nonperforming asset ratios consists of total loans held for investment and other nonperforming assets.

- (2) The nonperforming loan ratios, excluding acquired loans from the denominator, for home loan, retail banking, total consumer banking, commercial and multifamily real estate, commercial and industrial, total commercial banking, and total nonperforming loans held for investment were 5.79%, 2.11%, 1.66%, 1.25%, 0.77%, 1.00% and 0.63%,



**Table of Contents**

respectively, as of June 30, 2012, compared with 7.22%, 2.21%, 2.03%, 1.33%, 0.75%, 1.10% and 0.81%, respectively, as of December 31, 2011. The nonperforming asset ratio, excluding acquired loans, was 0.78% and 0.95% as of June 30, 2012 and December 31, 2011, respectively.

- (3) We recognized interest income for loans classified as nonperforming of \$16 million and \$11 million for the six months ended June 30, 2012 and 2011, respectively. Interest income foregone related to nonperforming loans was \$29 million and \$30 million for the six months ended June 30, 2012 and 2011, respectively. Foregone interest income represents the amount of interest income that would have been recorded during the period for nonperforming loans as of the end of the period had the loans performed according to their contractual terms.
- (4) Nonperforming loans as a percentage of loans held for investment, excluding credit card loans from the denominator, was 0.88% and 1.50% as of June 30, 2012 and December 31, 2011, respectively.
- (5) Includes \$184 million and \$86 million of foreclosed properties related to acquired loans, as of June 30, 2012 and December 31, 2011, respectively.

Total nonperforming loans included TDRs totaling \$183 million and \$170 million as of June 30, 2012 and December 31, 2011, respectively. The decrease in our nonperforming loan ratio to 0.50% as of June 30, 2012, from 0.78% as of December 31, 2011 was primarily attributable to the addition of the ING Direct acquired loans, as well as, the improvement in the credit quality of our consumer banking loans.

***Net Charge-Offs***

Net charge-offs consist of the unpaid principal balance of loans held for investment that we determine are uncollectible, net of recovered amounts. We exclude accrued and unpaid finance charges and fees and fraud losses from charge-offs.

Table 21 presents our net charge-off amounts and rates, by business segment, for the three and six months ended June 30, 2012, and 2011. We provide information on charge-off amounts by loan category below in Table 23. We also present net charge-off rates excluding acquired loans accounted for based on estimated cash flows expected to be collected over the life of the loans.

**Table of Contents****Table 21: Net Charge-Offs**

(Dollars in millions)	Three Months Ended June 30,						Six Months Ended June 30,					
	2012		2011		2012		2011		2012		2011	
	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>	Amount	Rate <sup>(1)</sup>	Rate <sup>(2)</sup>
Credit card	\$ 622	3.13%	3.14%	\$ 793	5.06%	5.06%	\$ 1,268	3.57%	3.58%	\$ 1,722	5.59%	5.59%
Consumer banking	93	0.48	1.02	88	1.01	1.17	201	0.60	1.15	221	1.29	1.50
Commercial banking	17	0.19	0.19	38	0.50	0.50	33	0.19	0.19	98	0.65	0.66
Other	6	18.04	18.04	12	23.96	23.96	16	20.97	20.97	35	31.51	31.51
<b>Total</b>	<b>\$ 738</b>	<b>1.53%</b>	<b>1.96%</b>	<b>\$ 931</b>	<b>2.91%</b>	<b>3.03%</b>	<b>\$ 1,518</b>	<b>1.76%</b>	<b>2.17%</b>	<b>\$ 2,076</b>	<b>3.28%</b>	<b>3.42%</b>
Average loans held for investment	\$ 192,632			\$ 127,916			\$ 172,767			\$ 126,504		
Average loans held for investment (excluding acquired loans) <sup>(3)</sup>	150,450			122,804			140,142			121,296		

(1) Calculated for each loan category by dividing net charge-offs for the period by average loans held for investment during the period.

(2) Calculated by excluding acquired loans from the denominator.

(3) The carrying value of acquired loans accounted for based on estimated expected cash flows to be collected was \$41.7 billion and \$4.7 billion as of June 30, 2012, and December 31, 2011, respectively.

**Loan Modifications and Restructurings**

As part of our customer retention efforts, we may modify loans for certain borrowers who have demonstrated performance under the previous terms. As part of our loss mitigation efforts, we may make loan modifications to a borrower experiencing financial difficulty that are intended to minimize our economic loss and avoid the need for foreclosure or repossession of collateral. We may provide short-term (three to twelve months) or long-term (greater than twelve months) modifications to improve the long-term collectability of the loan. Our most common types of modifications include a reduction in the borrower's initial monthly or quarterly principal and interest payment through an extension of the loan term, a reduction in the interest rate, or a combination of both. These modifications may result in our receiving the full amount due, or certain installments due, under the loan over a period of time that is longer than the period of time originally provided for under the terms of the loan. In some cases, we may curtail the amount of principal owed by the borrower. Loan modifications in which an economic concession has been granted to a borrower experiencing financial difficulty are accounted for and reported as TDRs. We also classify loan modifications that involve a trial period as TDRs.

Table 22 presents the loan balances as of June 30, 2012 and December 31, 2011 of loan modifications made as part of our loss mitigation efforts, all of which are considered to be TDRs. Table 22 excludes loan modifications that do not meet the definition of a TDR and acquired loans, which we track and report separately. We provide additional detail on acquired loans below under Acquired Loans.

**Table of Contents****Table 22: Loan Modifications and Restructurings<sup>(1)</sup>**

(Dollars in millions)	June 30, 2012	December 31, 2011
Modified and restructured loans:		
Credit card <sup>(2)</sup>	\$ 859	\$ 898
Automobile	75	58
Home loan	106	104
Retail banking	73	80
Commercial	404	426
<b>Total</b>	<b>\$ 1,517</b>	<b>\$ 1,566</b>
Status of modified and restructured loans:		
Performing	\$ 1,334	\$ 1,396
Nonperforming	183	170
<b>Total</b>	<b>\$ 1,517</b>	<b>\$ 1,566</b>

<sup>(1)</sup> Reflects modifications and restructuring of loans in our total loan portfolio. The total loan portfolio includes loans recorded on our balance sheet and loans held in securitization trusts.

<sup>(2)</sup> Amount reported reflects the total outstanding customer balance, which consists of unpaid principal balance, accrued interest and fees. The vast majority of our credit card TDR loan modifications involve a reduction in the interest rate on the account and placing the customer on a fixed payment plan not exceeding 60 months. In some cases, the interest rate on a credit card account is automatically increased due to non-payment, late payment or similar events. We determine the effective interest rate for purposes of measuring impairment on modified loans that involve an increase and are considered to be a TDR based on the interest rate in effect immediately prior to the loan entering the modification program. In all cases, we cancel the customer's available line of credit on the credit card. If the cardholder does not comply with the modified payment terms, then the credit card loan agreement may revert back to its original payment terms, with the amount of any loan outstanding reflected in the appropriate delinquency category. The loan amount may then be charged-off in accordance with our standard charge-off policy.

The majority of our modified home loans involve a combination of an interest rate reduction, term extension or principal reduction. The vast majority of modified commercial loans include a reduction in interest rate or a term extension.

We provide additional information on modified loans accounted for as TDRs, including the performance of those loans subsequent to modification, in Note 5 Loans.

**Impaired Loans**

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due from the borrower in accordance with the original contractual terms of the loan. Loans defined as individually impaired, based on applicable accounting guidance, include larger balance commercial nonperforming loans and TDR loans. We do not report nonperforming consumer loans that have not been modified in a TDR as individually impaired, as we collectively evaluate these smaller-balance homogenous loans for impairment in accordance with applicable accounting guidance. Loans held for sale are also not reported as impaired, as these loans are recorded at lower of cost or fair value. Impaired loans also exclude acquired loans accounted for based on expected cash flows because this accounting methodology takes into consideration future credit losses expected to be incurred, as discussed above under Summary of Selected Financial Data.

---

**Table of Contents**

Impaired loans, including TDRs, totaled \$1.8 billion as of both June 30, 2012 and December 31, 2011, respectively. TDRs accounted for \$1.5 billion and \$1.6 billion of impaired loans as of June 30, 2012 and December 31, 2011, respectively. We provide additional information on our impaired loans, including the allowance established for these loans in Note 5 Loans and Note 6 Allowance for Loan and Lease Losses.

***Acquired Loans***

Our portfolio of acquired loans consists of loans acquired in the HSBC U.S. card, ING Direct, and Chevy Chase Bank acquisitions. These loans were recorded at fair value as of the date of each acquisition.

***Acquired Loans Accounted for Based on Expected Cash Flows***

We use the term *acquired loans* to refer to a limited portion of the credit card loans acquired in the HSBC U.S. card acquisition and the substantial majority of consumer and commercial loans acquired in the ING Direct and Chevy Chase Bank acquisitions, which are accounted for based on expected cash flows to be collected. Acquired loans accounted for based on expected cash flows to be collected increased to \$41.7 billion as of June 30, 2012, from \$4.7 billion as of December 31, 2011. The increase was largely due to the ING Direct acquisition.

We regularly update our estimate of the amount of expected principal and interest to be collected from these loans and evaluate the results on an aggregated pool basis for loans with common risk characteristics. Probable decreases in expected loan principal cash flows would trigger the recognition of impairment through our provision for credit losses. Probable and significant increases in expected cash flows would first reverse any previously recorded allowance for loan and lease losses, with any remaining increase in expected cash flows recognized prospectively in interest income over the remaining estimated life of the underlying loans. We decreased the allowance and recorded a benefit through our provision for credit losses of \$2 million for the three months ended June 30, 2012 and increased the allowance and recorded a provision for credit losses of \$11 million for the six months ended June 30, 2012 related to certain pools of acquired loans. The cumulative impairment recognized on acquired loans totaled \$37 million and \$26 million as of June 30, 2012 and December 31, 2011, respectively. The credit performance of the remaining pools has generally been in line with our expectations, and, in some cases, more favorable than expected, which has resulted in the reclassification of amounts from the nonaccretable difference to the accretable yield.

***Acquired Loans Accounted for Based on Contractual Cash Flows***

Of the loans acquired in the HSBC U.S. card acquisition, there were loans of \$26.2 billion designated as held for investment that had existing revolving privileges at acquisition and were therefore excluded from the accounting guidance applied to the acquired loans described in the paragraphs above.

These loans were recorded at a fair value of \$26.9 billion, resulting in a net premium of \$705 million at acquisition. Fair value was determined by discounting all expected cash flows (contractual principal, interest, finance charges and fees of \$33.3 billion less those amounts not expected to be collected of \$3.0 billion) at a market discount rate.

Under applicable accounting guidance, we are required to amortize the net premium of \$705 million over the contractual principal amount as an adjustment to interest income over the remaining life of the loans. Given the guidance applicable to acquired revolving loans, it is necessary to record an allowance through provision expense to properly recognize an estimate of incurred losses on the existing principal balances, which represents a portion of the total amounts not expected to be collected described above. In the second quarter of 2012, we recorded provision expense of \$1.2 billion to establish an allowance primarily related to these loans. The allowance was calculated using the same methodology utilized for determining the allowance for our existing credit card portfolio. The provision expense of \$1.2 billion is included in the total provision for credit losses of \$1.7 billion recorded in the second quarter of 2012 as indicated in Note 6 Allowance for Loan and Lease Losses.

## **Table of Contents**

Excluded from the amounts above are acquired HSBC U.S. card revolving loans with a fair value of \$471 million that we designated as held for sale at acquisition. We expect to close the sale of these receivables early in the third quarter.

We provide additional information on acquired loans in Note 5 Loans.

## **Allowance for Loan and Lease Losses**

Our allowance for loan and lease losses represents management's best estimate of incurred loan and lease credit losses inherent in our held-for-investment portfolio as of each balance sheet date. We do not maintain an allowance for held-for-sale loans or acquired loans that are performing in accordance with or better than our expectations as of the date of acquisition, as the fair values of these loans already reflect a credit component. The allowance for loan and lease losses is increased through the provision for credit losses and reduced by net charge-offs. The provision for credit losses, which is charged to earnings, reflects credit losses we believe have been incurred and will eventually be reflected over time in our charge-offs. Charge-offs of uncollectible amounts are deducted from the allowance and subsequent recoveries are added. We describe our process for determining our allowance for loan and lease losses in Note 1 Summary of Significant Accounting Policies in our 2011 Form 10-K.

Table 23, which displays changes in our allowance for loan and lease losses for the three and six months ended June 30, 2012 and 2011, details, by loan type, the provision for credit losses recognized in our consolidated statements of income each period and the charge-offs recorded against our allowance for loan and lease losses.

**Table of Contents****Table 23: Summary of Allowance for Loan and Lease Losses**

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Balance at beginning of period, as reported	\$ 4,060	\$ 5,067	\$ 4,250	\$ 5,628
Provision for credit losses <sup>(1)(2)</sup>	1,686	350	2,265	920
<b>Charge-offs:</b>				
<b>Credit Card business:<sup>(2)</sup></b>				
Domestic credit card and installment	(746)	(905)	(1,534)	(1,997)
International credit card	(162)	(205)	(329)	(398)
Total credit card	(908)	(1,110)	(1,863)	(2,395)
<b>Consumer Banking business:</b>				
Automobile	(122)	(102)	(262)	(243)
Home loan	(19)	(22)	(43)	(54)
Retail banking	(20)	(25)	(40)	(55)
Total consumer banking	(161)	(149)	(345)	(352)
<b>Commercial Banking business:</b>				
Commercial and multifamily real estate	(8)	(15)	(17)	(40)
Commercial and industrial	(8)	(15)	(19)	(25)
Total commercial lending	(16)	(30)	(36)	(65)
Small-ticket commercial real estate	(8)	(20)	(24)	(53)
Total commercial banking	(24)	(50)	(60)	(118)
Other loans	(7)	(13)	(18)	(37)
Total charge-offs	(1,100)	(1,322)	(2,286)	(2,902)
<b>Recoveries:</b>				
<b>Credit Card business:</b>				
Domestic credit card and installment	236	267	493	555
International credit card	50	50	102	118
Total credit card	286	317	595	673
<b>Consumer Banking business:</b>				
Automobile	54	50	115	102
Home loan	7	5	16	16
Retail banking	7	6	13	13
Total consumer banking	68	61	144	131
<b>Commercial Banking business:</b>				
Commercial and multifamily real estate	1	2	6	7
Commercial and industrial	3	6	17	9
Total commercial lending	4	8	23	16
Small-ticket commercial real estate	3	4	4	4

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Total commercial banking	7	12	27	20
Other loans	1	1	2	2
Total recoveries	362	391	768	826
Net charge-offs	(738)	(931)	(1,518)	(2,076)
Impact from loan sales and other changes <sup>(2)</sup>	(10)	2	1	16
Balance at end of period	\$ 4,998	\$ 4,488	\$ 4,998	\$ 4,488

**Table of Contents**

(1) Excludes a negative provision for unfunded lending commitments of \$9 million and \$7 million for the three months ended June 30, 2012 and 2011, respectively and \$15 million and \$43 million for the six months ended June 30, 2012 and 2011, respectively.

(2) Includes foreign translation adjustments of \$10 million and \$21 million for the second quarter and first six months of 2012, respectively. Table 24 presents an allocation of our allowance for loan and lease losses, by loan category, as of June 30, 2012 and December 31, 2011.

**Table 24: Allocation of the Allowance for Loan and Lease Losses**

(Dollars in millions)	June 30, 2012		December 31, 2011	
	Amount	% of Total HFI Loans <sup>(1)</sup>	Amount	% of Total HFI Loans <sup>(1)</sup>
<b>Credit Card:</b>				
Domestic credit card and installment	\$ 3,295	4.08%	\$ 2,375	4.20%
International credit card	455	5.61	472	5.58
Total credit card	3,750	4.22	2,847	4.37
<b>Consumer Banking:</b>				
Auto	447	1.77	391	1.80
Home loan	87	0.18	98	0.94
Retail banking	135	3.26	163	3.97
Total consumer banking	669	0.86	652	1.80
<b>Commercial Banking:</b>				
Commercial and multifamily real estate	309	1.90	415	2.64
Commercial and industrial	138	0.75	199	1.17
Total commercial lending	447	1.29	614	1.87
Small-ticket commercial real estate	88	6.59	101	6.75
Total commercial banking	535	1.48	715	2.08
Other loans	44	26.83	36	20.57
Total	\$ 4,998	2.47%	\$ 4,250	3.13%
<b>Total allowance coverage ratios:</b>				
Period-end loans	\$ 202,749	2.47%	\$ 135,892	3.13%
Period-end loans (excluding acquired loans)	161,076	3.10	131,207	3.24
Nonperforming loans <sup>(2)</sup>	1,010	494.85	1,059	401.32
<b>Allowance coverage ratios by loan category:</b>				
Credit card (30 + day delinquent loans)	\$ 2,644	141.83%	\$ 2,511	113.38%
Consumer banking (30 + day delinquent loans)	1,916	34.92	2,176	29.96
Commercial banking (nonperforming loans)	356	150.28	372	192.20

(1) Calculated based on the allowance for loan and lease losses attributable to each loan category divided by the outstanding balance of loans within the specified loan category.

(2) As permitted by regulatory guidance issued by the FFEIC, our policy is generally not to classify credit card loans as nonperforming. We accrue interest on credit card loans through the date of charge-off, typically in the period that the loan becomes 180 days past due. The allowance for loan and lease losses as a percentage of nonperforming loans, excluding the allowance related to our credit card loans, was 123.56% as of June 30, 2012 and 132.48% as of December 31, 2011.



Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

We increased our allowance by \$748 million in the first six months of 2012 to \$5.0 billion as of June 30, 2012. The increase was primarily driven by the establishment of an allowance of \$1.2 billion primarily related to the

**Table of Contents**

addition of the \$26.2 billion in outstanding HSBC U.S. card loans that had existing revolving privilege at acquisition. The allowance for these loans was calculated using the same methodology utilized for determining the allowance for our existing credit card loan portfolio.

Although the allowance increased, the coverage ratio of the allowance to total loans held for investment fell by 66 basis points to 2.47% as of June 30, 2012, from 3.13% as of December 31, 2011. The decrease in the allowance coverage ratio was largely due to the addition of the acquired HSBC U.S. card and ING Direct loans accounted for based on estimated cash flows expected to be collected. As discussed above in Summary of Selected Financial Data, because the accounting for these loans takes into consideration future credit losses expected to be incurred, there are no charge-offs or an allowance associated with these loans unless the estimated cash flows expected to be collected decrease subsequent to acquisition. We did not have an allowance associated with these loans as of June 30, 2012.

See Note 6 Allowance for Loan and Lease Losses in this Report for additional information. Also see Note 1 Summary of Significant Accounting Policies in our 2011 Form 10-K for information on the allowance methodology for our credit card loan portfolio.

**LIQUIDITY RISK PROFILE****Liquidity**

We have established liquidity guidelines that are intended to ensure that we have sufficient asset-based liquidity to withstand the potential impact of deposit attrition or diminished liquidity in the funding markets. Our guidelines include maintaining an adequate liquidity reserve to cover our potential funding requirements and diversified funding sources to avoid over-dependence on volatile, less reliable funding markets. Our liquidity reserves consist of cash and cash equivalents and unencumbered available-for-sale securities. Table 25 below presents the fair value of our liquidity reserves as of June 30, 2012 and December 31, 2011. Our liquidity reserves increased by \$17.9 billion in the first six months of 2012, to \$53.7 billion as of June 30, 2012. This increase was primarily driven by an increase in available-for-sale securities from our acquisition of ING Direct and an increase in cash from our equity and debt offerings during the first quarter of 2012.

**Table 25: Liquidity Reserves**

(Dollars in millions)	June 30, 2012	December 31, 2011
Cash and cash equivalents	\$ 5,979	\$ 5,838
Securities available-for-sale <sup>(1)</sup>	55,289	38,759
Less: Pledged available-for-sale securities	(7,615)	(8,762)
Unencumbered available-for-sale securities	47,674	29,997
Total liquidity reserves	\$ 53,653	\$ 35,835

<sup>(1)</sup> The weighted average life of our available-for-sale securities was approximately 3.7 years and 2.9 years as of June 30, 2012 and December 31, 2011, respectively.

See MD&A Risk Management in our 2011 Form 10-K for additional information on our management of liquidity risk.

**Funding**

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Our funding objective is to establish an appropriate maturity profile using a cost-effective mix of both short-term and long-term funds. We use a variety of funding sources, including deposits, short-term borrowings, the issuance of senior and subordinated notes and other borrowings, and, to a lesser extent, loan securitizations

**Table of Contents**

transactions. In addition, we utilize advances from the Federal Home Loan Bank ( FHLB ), which are secured by certain portions of our loan portfolios and investment securities, for our funding needs.

**Deposits**

Our deposits provide a stable and relatively low cost of funds and are our largest source of funding. Table 26 presents the composition of our deposits by type as of June 30, 2012 and December 31, 2011.

**Table 26: Deposits**

(Dollars in millions)	June 30, 2012	December 31, 2011
Non-interest bearing	\$ 20,072	\$ 18,281
NOW accounts	36,417	15,038
Money market deposit accounts	107,806	46,496
Savings accounts	30,554	31,433
Other consumer time deposits	13,181	11,471
Total core deposits	208,030	122,719
Public fund certificates of deposit \$100,000 or more	69	85
Certificates of deposit \$100,000 or more	4,890	4,501
Foreign time deposits	942	921
Total deposits	\$ 213,931	\$ 128,226

Total deposits increased by \$85.7 billion, or 67%, in the first six month of 2012 to \$213.9 billion as of June 30, 2012. The increase in deposits reflects the addition of \$84.4 billion in deposits from the ING Direct acquisition and increased retail marketing efforts to attract new business and continued strategy to leverage our bank outlets to attract lower cost deposit funding. Of our total deposits, approximately \$942 million and \$921 million were held in foreign banking offices as of June 30, 2012 and December 31, 2011, respectively. Large denomination domestic certificates of deposits of \$100,000 or more represented \$5.0 billion and \$4.6 billion of our total deposits as of June 30, 2012 and December 31, 2011, respectively.

We have brokered deposits, which we obtained through the use of third-party intermediaries. Brokered deposits are included in money market deposit accounts and other consumer time deposits in Table 26 above. The Federal Deposit Insurance Corporation Improvement Act of 1991 limits the use of brokered deposits to well-capitalized insured depository institutions and, with a waiver from the Federal Deposit Insurance Corporation, to adequately capitalized institutions. COBNA, CONA and ING Bank, fsb were well-capitalized, as defined under the federal banking regulatory guidelines, as of June 30, 2012, and therefore permitted to maintain brokered deposits. Our brokered deposits totaled \$12.1 billion, or 6% of total deposits, as of June 30, 2012 and \$13.0 billion, or 10% of total deposits, as of December 31, 2011. We expect to replace maturing brokered deposits with new brokered deposits or direct deposits and branch deposits.

**Short-Term Borrowings**

We also have access to and utilize various other short-term borrowings to support our operations. These borrowings are generally in the form of federal funds purchased and securities loaned or sold under agreements to repurchase, most of which are overnight borrowings. Other short-term borrowings do not represent a significant portion of our overall funding.

**Other Funding Sources**

Our debt, including federal funds purchased and securities loaned or sold under agreements to repurchase, senior and subordinated notes and other borrowings, such as FHLB advances, but excluding securitized debt



**Table of Contents**

obligations, totaled \$22.3 billion as of June 30, 2012, decreased from \$23.0 billion as of December 31, 2011. The decrease in our debt, excluding securitized debt obligations, was primarily attributable to a \$1.8 billion decrease in short-term borrowings, a decrease of \$282 million due to the maturity of outstanding senior notes, and the proceeds of approximately \$1.25 billion from the issuance of new senior notes. We participate in the federal funds market on a regular basis, which is intended to ensure that we are able to access the federal funds market in a time of need. We expect monthly fluctuations in our borrowings, as borrowing amounts are highly dependent on our counterparties' cash positions. Our FHLB membership is secured by our investment in FHLB stock, which totaled \$686 million as of June 30, 2012.

Table 27 presents our short-term borrowings and long-term debt and the maturity profile based on expected maturities as of June 30, 2012. We provide additional information on our short-term borrowings and long-term debt in Note 9 Deposits and Borrowings.

**Table 27: Expected Maturity Profile of Short-term Borrowings and Long-term Debt**

(Dollars in millions)	Up to 1 Year	> 1 Year to 2 Years	> 2 Years to 3 Years	> 3 Years to 4 Years	> 4 Years To 5 Years	> 5 Years	Total
<b>Short-term borrowings:</b>							
Federal funds purchased and securities loaned or sold under agreements to repurchase	\$ 1,101	\$	\$	\$	\$	\$	\$ 1,101
FHLB advances	4,400						4,400
Total short-term borrowings	5,501						5,501
<b>Long-term debt:</b>							
Securitized debt obligations	4,205	3,322	430	908	2,878	1,865	13,608
Senior and subordinated notes:							
Unsecured senior debt		577	3,294	471	1,003	2,792	8,137
Unsecured subordinated debt	351	514	105		1,190	1,782	3,942
Total senior and subordinated notes	351	1,091	3,399	471	2,193	4,574	12,079
Other long-term borrowings:							
Junior subordinated debt						3,642	3,642
FHLB advances	13	28	940	9	33	21	1,044
Other long-term borrowings	13	28	940	9	33	3,663	4,686
Total long-term debt <sup>(1)</sup>	4,569	4,441	4,769	1,388	5,104	10,102	30,373
Total short-term borrowings and long-term debt	\$ 10,070	\$ 4,441	\$ 4,769	\$ 1,388	\$ 5,104	\$ 10,102	\$ 35,874
Percentage of total	28%	13%	13%	4%	14%	28%	100%

<sup>(1)</sup> Includes unamortized discounts, premiums and other cost basis adjustments of \$29 million as of June 30, 2012.

**Borrowing Capacity**

We filed a new effective shelf registration statement with the U.S. Securities & Exchange Commission ( SEC ) on April 30, 2012, which will expire three years from the filing date, under which, from time to time, we may offer and sell an indeterminate aggregate amount of senior or subordinated debt securities, preferred stock, depository shares, common stock, purchase contracts, warrants and units. There is no limit under this shelf registration statement to the amount or number of such securities that we may offer and sell. During the first six months of 2012, we issued new senior notes in the total amount of \$1.25 billion, due 2015.



**Table of Contents**

In addition to issuance capacity under the shelf registration statement, we also have access to FHLB advances and letters of credit with a maximum borrowing capacity of \$29.5 billion as of June 30, 2012. We had \$5.4 billion outstanding as of June 30, 2012, and collateral pledged that would support an incremental \$24.3 billion of borrowings. This funding source is non-revolving, and funding availability is subject to market conditions. The ability to draw down funding is based on membership status, and the amount is dependent upon the Banks' ability to post collateral.

**Credit Ratings**

Our credit ratings have a significant impact on our ability to access capital markets and our borrowing costs. Rating agencies base their ratings on numerous factors, including liquidity, capital adequacy, asset quality, quality of earnings and the probability of systemic support. Significant changes in these factors could result in different ratings. Our equity capital and funding strategies are designed, among other things, to maintain appropriate and stable unsecured debt ratings from the major credit ratings agencies, Moody's, S&P, Fitch and DBRS. Such ratings help to support our cost effective unsecured funding as part of our overall financing programs. Table 28 provides a summary of the credit ratings for the senior unsecured debt of Capital One Financial Corporation, COBNA, and CONA as of June 30, 2012 and a comparison to the ratings as of December 31, 2011.

**Table 28: Senior Unsecured Debt Credit Ratings**

	June 30, 2012			December 31, 2011		
	Capital One Financial Corporation	Capital One Bank (USA), N.A.	Capital One, N.A.	Capital One Financial Corporation	Capital One Bank (USA), N.A.	Capital One, N.A.
Moody's	Baa1	A3	A3	Baa1	A3	A3
S&P	BBB	BBB+	BBB+	BBB	BBB+	BBB+
Fitch	A-	A-	A-	A-	A-	A-
DBRS	BBB**	A*	A*	BBB**	A*	A*

\* low

\*\* high

As of July 31, 2012, Moody's, Fitch and DBRS had us on a stable outlook, while S&P had us on negative outlook.

**MARKET RISK PROFILE**

Market risk is inherent in the financial instruments associated with our operations and activities, including loans, deposits, securities, short-term borrowings, long-term debt and derivatives. Below we provide additional information about our primary sources of market risk, our market risk management strategies and measures used to evaluate our market risk exposure.

**Primary Market Risk Exposures**

Our primary sources of market risk include interest rate risk and foreign exchange risk.

**Interest Rate Risk**



## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Interest rate risk, which represents exposure to instruments whose yield or price varies with the level or volatility of interest rates, is our most significant source of market risk exposure. Banks are inevitably exposed to interest rate risk due to differences in the timing between the maturities or repricing of assets and liabilities. For example, if more assets are repricing than deposits and other borrowings when interest rates are declining, our earnings will decrease. Similarly, if more deposits and other borrowings are repricing than assets when interest rates are rising, our earnings will decrease. Interest rate risk also results from changes in customer behavior and

## **Table of Contents**

competitors' responses to changes in interest rates or other market conditions. For example, decreases in mortgage rates generally result in faster than expected prepayments, which may adversely affect earnings. Increases in interest rates, coupled with strong demand from competitors for deposits, may influence industry pricing. Such competition may affect customer decisions to maintain balances in the deposit accounts, which may require replacing lower cost deposits with higher cost alternative sources of funding.

### ***Foreign Exchange Risk***

Foreign exchange risk represents exposure to changes in the values of current holdings and future cash flows denominated in other currencies. The types of instruments exposed to this risk include investments in foreign subsidiaries, foreign currency-denominated loans and securities, future cash flows in foreign currencies arising from foreign exchange transactions, foreign currency-denominated debt and various foreign exchange derivative instruments whose values fluctuate with changes in the level or volatility of currency exchange rates or foreign interest rates.

We are exposed to changes in foreign exchange rates, which may impact the earnings of our foreign operations. Our asset/liability management policy requires that we use derivatives to hedge material foreign currency denominated transactions to limit our earnings exposure to foreign exchange risk.

### **Market Risk Management**

We employ several techniques to manage our interest rate and foreign currency risk, which include, but are not limited to, changing the maturity and re-pricing characteristics of our various assets and liabilities. Derivatives are one of the primary tools we use in managing interest rate and foreign exchange risk. We execute our derivative contracts in both over-the-counter and exchange-traded derivative markets. Although the majority of our derivatives are interest rate swaps, we also use a variety of other derivative instruments, including caps, floors, options, futures and forward contracts, to manage our interest rate and foreign currency risk.

The outstanding notional amount of our derivative contracts decreased to \$55.3 billion as of June 30, 2012, from \$73.2 billion as of December 31, 2011. This decrease was primarily attributable to the termination of interest-rate swaps of \$24.8 billion that we entered into in the second half of 2011 to manage the anticipated impact of the ING Direct acquisition on our market risk exposure and regulatory capital requirements. These swap transactions mitigated the effect of a rise in interest rates on the fair values of a significant portion of the ING Direct assets and liabilities during the period from when we entered into the swap transactions to the closing date of the ING Direct acquisition in early 2012.

### **Market Risk Measurement**

We have prescribed risk management policies and limits established by our Asset/Liability Management Committee. Our objective is to manage our asset/liability risk position and exposure to market risk in accordance with these policies and prescribed limits based on prevailing market conditions and long-term expectations. Because no single measure can reflect all aspects of market risk, we use various industry standard market risk measurement techniques and analyses to measure, assess and manage the impact of changes in interest rates and foreign exchange rates on our earnings and the economic value of equity.

We consider the impact on both earnings and economic value of equity in measuring and managing our interest rate risk. Our earnings sensitivity measure estimates the impact on net interest income and the valuation of our mortgage servicing rights, including derivative hedging activity, resulting from movements in interest rates. Our economic value of equity sensitivity measure estimates the impact on the net present value of our assets and liabilities, including derivative hedging activity, resulting from movements in interest rates. Our earnings sensitivity and economic value of equity measurements are based on our existing assets and liabilities, including derivatives, and do not incorporate business growth assumptions or projected plans for funding mix changes. We

**Table of Contents**

do, however, assess and factor into our interest rate risk management decisions the potential impact of growth assumptions, changing business activities and alternative interest rate scenarios, such as a steepening or flattening of the yield curve.

Under our current asset/liability management policy, our objective is to: (i) limit the potential decrease in our projected net interest income resulting from a gradual plus or minus 200 basis point change in forward rates to less than 5% over the next 12 months and (ii) limit the adverse change in the economic value of our equity due to an instantaneous parallel interest rate shock to spot rates of plus or minus 200 basis points to less than 12%. The federal funds rate remained at a target range of zero to 0.25% during the second quarter of 2012. Given the level of short-term rates as of June 30, 2012 and December 31, 2011, a scenario where interest rates would decline by 200 basis points is highly unlikely. In 2008, we temporarily revised our customary declining interest rate scenario of 200 basis points to a 50 basis point decrease, except in scenarios where a 50 basis point decline would result in a rate less than 0% (in which case we assume a rate scenario of 0%), to compensate for the continued low rate environment. Our current asset/liability management policy also includes the use of derivatives to hedge material foreign currency denominated transactions to limit our earnings exposure to foreign exchange risk.

Table 29 shows the estimated percentage impact on our adjusted projected net interest income and economic value of equity, calculated under our base case interest rate scenario, as of June 30, 2012 and December 31, 2011, resulting from selected hypothetical interest rate scenarios. Our adjusted projected net interest income consists of net interest income adjusted to include changes in the fair value of mortgage service rights, including related derivative hedging activity, and changes in the fair value of free-standing interest rate swaps. In measuring the sensitivity of interest rate movements on our adjusted projected net interest income, we assume a hypothetical gradual increase in interest rates of 200 basis points and a hypothetical gradual decrease of 50 basis points to forward rates over the next twelve months. In measuring the sensitivity of interest rate movements on our economic value of equity, we assume a hypothetical instantaneous parallel shift in the level of interest rates of plus 200 basis points and minus 50 basis points to spot rates in measuring the sensitivity of the valuation of our economic value of equity.

**Table 29: Interest Rate Sensitivity Analysis**

(Dollars in millions)	June 30, 2012	December 31, 2011	
		Excluding ING Direct Swaps <sup>(1)</sup>	Including ING Direct Swaps
Impact on adjusted projected base-line net interest income:			
+ 200 basis points	(0.5)%	1.2%	13.7%
- 50 basis points	0.0	(0.5)	(3.9)
Impact on economic value of equity:			
+ 200 basis points	(1.6)	(1.0)	3.2
- 50 basis points	(0.7)	(0.4)	(1.5)

<sup>(1)</sup> Calculated excluding the impact of the interest-rate swap transactions of approximately \$24.8 billion entered into to mitigate some of the interest rate risk related to the ING Direct acquisition.

Because of the large but temporary impact of the ING Direct-related swap transactions on our standard interest rate risk reporting measures, we expanded our standard interest rate sensitivity analysis to present our interest rate risk measures as of December 31, 2011 both with and without the impact of the \$24.8 billion of interest rate swaps described above. This presentation highlights changes in our core interest rate risk profile and the incremental impact of the ING Direct-related swaps on our core profile over the time period that the swaps were outstanding. Excluding the \$24.8 billion swap transactions, our interest rate sensitivity measures reflect that we became less asset sensitive between December 31, 2011 and June 30, 2012. Our projected net interest income and economic value of equity sensitivity measures, both including and excluding the impact of the ING Direct related swap transactions, were within our prescribed asset/liability policy limits as of June 30, 2012 and December 31, 2011.

## **Table of Contents**

### ***Limitations of Market Risk Measures***

The interest rate risk models that we use in deriving these measures incorporate contractual information, internally-developed assumptions and proprietary modeling methodologies, which project borrower and deposit behavior patterns in certain interest rate environments. Other market inputs, such as interest rates, market prices and interest rate volatility, are also critical components of our interest rate risk measures. We regularly evaluate, update and enhance these assumptions, models and analytical tools as we believe appropriate to reflect our best assessment of the market environment and the expected behavior patterns of our existing assets and liabilities.

There are inherent limitations in any methodology used to estimate the exposure to changes in market interest rates. The above sensitivity analyses contemplate only certain movements in interest rates and are performed at a particular point in time based on the existing balance sheet, and do not incorporate other factors that may have a significant effect, most notably future business activities and strategic actions that management may take to manage interest rate risk. Actual earnings and economic value of equity could differ from the above sensitivity analyses.

## **SUPERVISION AND REGULATION**

### **Required Enhancements to Compliance and Risk Management Programs**

In recent weeks, we have been party to several consent orders and settlement agreements with certain federal agencies. On July 17, 2012, Capital One Bank (U.S.A.), N.A. entered into consent orders with each of the OCC and the CFPB relating to oversight of our vendor sales practices of payment protection and credit monitoring products. On July 26, 2012, Capital One Bank (U.S.A.), N.A. and Capital One, N.A. entered into consent orders with each of the Department of Justice and the OCC relating to compliance with the Servicemembers Civil Relief Act, or the SCRA, and, in the case of the OCC orders, third-party management.

In addition, in the first quarter of 2012, we closed the ING Direct acquisition. In its order approving the acquisition, the Federal Reserve Board required Capital One to enhance our risk-management systems and policies enterprise-wide to account for the changes to our business lines that would result from the acquisitions of ING Direct and HSBC's credit card operations in the U.S.

Among other things, our regulators require us to make enhancements to our compliance and risk management programs on an enterprise-wide basis in the following primary areas:

Compliance with laws, rules and regulations regarding unfair and deceptive practices;

Compliance with the SCRA;

Compliance monitoring and transaction testing capabilities to detect any instances of non-compliance with consumer compliance laws and regulations;

Third-party management, especially in the context of compliance with consumer laws and regulations; and

Internal controls, policies and procedures and oversight by the Board and senior management.

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Much of this work is already underway, and the financial impacts of the customer restitution required and the civil monetary penalties to be paid under the various consent orders were reflected in our recent results of operations. The enhancements to these compliance and risk management programs could put upward pressure on our operating expenses in future periods. However, we cannot at this time predict with certainty whether our overall operating expenses will increase materially as a result.

We are continuing to make significant changes to our systems and processes in order to enhance our enterprise-wide compliance and risk management programs. There will continue to be heightened regulatory oversight by the federal banking regulators to ensure that we build systems and processes that are commensurate with the nature of our business, and we expect this heightened oversight will continue for the foreseeable future until we meet the expectations of our regulators and can demonstrate that such systems and processes are sustainable.

## **Table of Contents**

### **ING Bank**

On February 17, 2012, in connection with the ING Direct acquisition, we acquired all the shares of ING Bank, fsb ( ING Bank ) and its subsidiaries and certain of its affiliates. ING Bank is a federal savings association chartered under the laws of the United States, the deposits of which are insured by the Federal Deposit Insurance Corporation ( FDIC ) up to applicable limits. Subject to the receipt of all regulatory approvals, we expect to merge ING Bank with and into CONA in the fourth quarter of this year.

### **Basel III and Other Capital Rule Proposals**

The Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency and FDIC released in June 2012 three proposed rules that would substantially revise the federal banking agencies' current capital rules and implement the Basel Committee on Banking Supervision's December 2010 regulatory capital reforms, known as Basel III. The first proposal, known as the Basel III proposal, would increase the general risk-based capital ratio minimum requirements; modify the definition of regulatory capital; introduce a new capital conservation buffer requirement; and update the prompt corrective action ( PCA ) framework to reflect the new regulatory capital minimums. For those institutions subject to the Basel II Advanced Approaches framework, known as Advanced Approaches institutions, the proposal would also implement a supplementary leverage ratio that incorporates a broader set of exposures in the denominator and would introduce a new countercyclical capital buffer requirement. As discussed in more detail in our 2011 Form 10-K, we expect to be subject to the Basel II Advanced Approaches rules at the end of 2012 as a result of the ING Direct acquisition.

The second proposal, known as the Standardized Approach proposal, would revise the federal banking agencies' general approach for calculating risk-weighted assets, to reflect a more risk-sensitive risk-weighting approach and remove reliance on external credit ratings, as required by Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act ( Dodd-Frank Act ). The third proposal would modify the existing Basel II Advanced Approaches rules for calculating risk-weighted assets, by implementing elements of the Basel III framework and removing reliance on external credit ratings. Pursuant to Section 171 (commonly referred to as the Collins Amendment) of the Dodd-Frank Act, an Advanced Approaches institution must calculate its risk-based capital under both the Standardized Approach and the Advanced Approach and use the lower of each of the relevant capital ratios to determine whether it meets the minimum risk-based capital requirements.

The proposed rules would go into effect according to different start dates and phase-in periods, beginning with January 1, 2013. If finalized as proposed, the rules would increase the minimum capital that we and other institutions would be required to hold. We will continue to monitor regulators' implementation of the new rules and assess the potential impact to us.

We provide information on our supervision and regulation in our 2011 Form 10-K under Part I Item 1. Business Supervision and Regulation.

## **ACCOUNTING CHANGES AND DEVELOPMENTS**

See Note 1 Summary of Significant Accounting Policies for information concerning recently issued accounting pronouncements, including those that we have not yet adopted and that will likely affect our consolidated financial statements.

## **FORWARD-LOOKING STATEMENTS**

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

From time to time, we have made and will make forward-looking statements, including those that discuss, among other things, strategies, goals, outlook or other non-historical matters; projections, revenues, income, expenses, capital measures, returns, accruals for claims in litigation and for other claims against us; earnings per share or

**Table of Contents**

other financial measures for us; future financial and operating results; our plans, objectives, expectations and intentions; the projected impact and benefits of the ING Direct and HSBC U.S. card acquisitions (collectively, the Transactions); and the assumptions that underlie these matters.

To the extent that any such information is forward-looking, it is intended to fit within the safe harbor for forward-looking information provided by the Private Securities Litigation Reform Act of 1995. Numerous factors could cause our actual results to differ materially from those described in such forward-looking statements, including, among other things:

general economic and business conditions in the U.S., the U.K., Canada and our local markets, including conditions affecting employment levels, interest rates, consumer income and confidence, spending and savings that may affect consumer bankruptcies, defaults, charge-offs and deposit activity;

an increase or decrease in credit losses (including increases due to a worsening of general economic conditions in the credit environment);

the possibility that we may not fully realize the projected cost savings and other projected benefits of the Transactions;

difficulties and delays in integrating the assets and businesses acquired in the Transactions;

business disruption following the Transactions;

diversion of management time on issues related to the Transactions, including integration of the assets and businesses acquired;

reputational risks and the reaction of customers and counterparties to the Transactions;

disruptions relating to the Transactions negatively impacting our ability to maintain relationships with customers, employees and suppliers;

changes in asset quality and credit risk as a result of the Transactions;

the accuracy of estimates and assumptions we use to determine the fair value of assets acquired and liabilities assumed in the Transactions, and the potential for our estimates or assumptions to change as additional information becomes available and we complete the accounting analysis of the Transactions;

financial, legal, regulatory, tax or accounting changes or actions, including the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the regulations promulgated thereunder;

developments, changes or actions relating to any litigation matter involving us;

the inability to sustain revenue and earnings growth;



increases or decreases in interest rates;

our ability to access the capital markets at attractive rates and terms to capitalize and fund our operations and future growth;

the success of our marketing efforts in attracting and retaining customers;

increases or decreases in our aggregate loan balances or the number of customers and the growth rate and composition thereof, including increases or decreases resulting from factors such as shifting product mix, amount of actual marketing expenses we incur and attrition of loan balances;

the level of future repurchase or indemnification requests we may receive, the actual future performance of mortgage loans relating to such requests, the success rates of claimants against us, any developments in litigation and the actual recoveries we may make on any collateral relating to claims against us;

the amount and rate of deposit growth;

changes in the reputation of or expectations regarding the financial services industry or us with respect to practices, products or financial condition;

**Table of Contents**

any significant disruption in our operations or technology platform;

our ability to maintain a compliance infrastructure suitable for the nature of our business;

our ability to control costs;

the amount of, and rate of growth in, our expenses as our business develops or changes or as it expands into new market areas;

our ability to execute on our strategic and operational plans;

any significant disruption of, or loss of public confidence in, the United States Mail service affecting our response rates and consumer payments;

our ability to recruit and retain experienced personnel to assist in the management and operations of new products and services;

changes in the labor and employment markets;

fraud or misconduct by our customers, employees or business partners;

competition from providers of products and services that compete with our businesses; and

other risk factors listed from time to time in reports that we file with the SEC.

Any forward-looking statements made by or on behalf of Capital One speak only as of the date they are made or as of the date indicated, and Capital One does not undertake any obligation to update forward-looking statements as a result of new information, future events or otherwise. You should carefully consider the factors discussed above in evaluating these forward-looking statements. For additional information on factors that could materially influence forward-looking statements included in this report, see the risk factors in this report in Part II Item 1A. Risk Factors and in our 2011 Form 10-K in Part I Item 1A. Risk Factors.

**Table of Contents**

## SUPPLEMENTAL TABLES

**Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures**

(Dollars in millions) (unaudited)	June 30, 2012 <sup>(1)</sup>	December 31, 2011
<b>Stockholders' Equity to Non-GAAP Tangible Common Equity</b>		
Total stockholders' equity	\$ 37,192	\$ 29,666
Less: Intangible assets <sup>(2)</sup>	(16,477)	(13,908)
Tangible common equity	\$ 20,715	\$ 15,758
<b>Total Assets to Tangible Assets</b>		
Total assets	\$ 296,572	\$ 206,019
Less: Assets from discontinued operations	(310)	(305)
Total assets from continuing operations	296,262	205,714
Less: Intangible assets <sup>(2)</sup>	(16,477)	(13,908)
Tangible assets	\$ 279,785	\$ 191,806
<b>Non-GAAP TCE Ratio</b>		
Tangible common equity	\$ 20,715	\$ 15,758
Tangible assets	279,785	191,806
TCE ratio <sup>(3)</sup>	7.4%	8.2%
<b>Regulatory Capital and Non-GAAP Tier 1 Common Equity Ratios</b>		
Total stockholders' equity	\$ 37,192	\$ 29,666
Less: Net unrealized gains recorded in AOCI <sup>(4)</sup>	(422)	(289)
Net losses on cash flow hedges recorded in AOCI <sup>(4)</sup>	34	71
Disallowed goodwill and other intangible assets <sup>(5)</sup>	(14,563)	(13,855)
Disallowed deferred tax assets	(758)	(534)
Other	(12)	(2)
Tier 1 common capital	21,471	15,057
Plus: Tier 1 restricted core capital items <sup>(6)</sup>	3,636	3,635
Tier 1 capital	25,107	18,692
Plus: Long-term debt qualifying as Tier 2 capital	2,318	2,438
Qualifying allowance for loan and lease losses	2,740	1,979
Other Tier 2 components	15	23
Tier 2 capital	5,073	4,440
Total risk-based capital <sup>(7)</sup>	\$ 30,180	\$ 23,132
Risk-weighted assets <sup>(8)</sup>	\$ 216,341	\$ 155,657

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Tier 1 common ratio <sup>(9)</sup>	<b>9.9%</b>	9.7%
Tier 1 risk-based capital ratio <sup>(10)</sup>	<b>11.6</b>	12.0
Total risk-based capital ratio <sup>(11)</sup>	<b>14.0</b>	14.9

(1) Regulatory capital ratios as of June 30, 2012 are preliminary and therefore subject to change.

(2) Includes impact from related deferred taxes.

(3) Calculated based on tangible common equity divided by tangible assets.

(4) Amounts presented are net of tax.

(5) Disallowed goodwill and other intangible assets are net of related deferred tax liability.

(6) Consists primarily of trust preferred securities.

(7) Total risk-based capital equals the sum of Tier 1 capital and Tier 2 capital.

**Table of Contents**

- (8) Calculated based on prescribed regulatory guidelines.
- (9) Tier 1 common ratio is a regulatory capital measure calculated based on Tier 1 common capital divided by risk-weighted assets.
- (10) Tier 1 risk-based capital ratio is a regulatory capital measure calculated based on Tier 1 capital divided by risk-weighted assets.
- (11) Total risk-based capital ratio is a regulatory capital measure calculated based on total risk-based capital divided by risk-weighted assets.

**Table of Contents****Item 1. Financial Information and Supplementary Data****CAPITAL ONE FINANCIAL CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

<b>(Dollars in millions, except per share data)</b>	<b>June 30, 2012</b>	<b>December 31, 2011</b>
<b>Assets:</b>		
Cash and due from banks	\$ 2,297	\$ 2,097
Interest-bearing deposits with banks	3,352	3,399
Federal funds sold and securities purchased under agreements to resell	330	342
Cash and cash equivalents	5,979	5,838
Restricted cash for securitization investors	370	791
Securities available for sale, at fair value	55,289	38,759
Loans held for investment:		
Unsecuritized loans held for investment, at amortized cost	158,680	88,242
Restricted loans for securitization investors	44,069	47,650
Total loans held for investment	202,749	135,892
Less: Allowance for loan and lease losses	(4,998)	(4,250)
Net loans held for investment	197,751	131,642
Loans held for sale, at lower-of-cost-or-fair value	1,047	201
Accounts receivable from securitizations	96	94
Premises and equipment, net	3,556	2,748
Interest receivable	1,623	1,029
Goodwill	13,864	13,592
Other	16,997	11,325
<b>Total assets</b>	<b>\$ 296,572</b>	<b>\$ 206,019</b>
<b>Liabilities:</b>		
Interest payable	\$ 462	\$ 466
Customer deposits:		
Non-interest bearing deposits	20,072	18,281
Interest bearing deposits	193,859	109,945
Total customer deposits	213,931	128,226
Securitized debt obligations	13,608	16,527
Other debt:		
Federal funds purchased and securities loaned or sold under agreements to repurchase	1,101	1,464
Senior and subordinated notes	12,079	11,034
Other borrowings	9,086	10,536
Total other debt	22,266	23,034
Other liabilities	9,113	8,100
<b>Total liabilities</b>	<b>259,380</b>	<b>176,353</b>
<b>Stockholders equity:</b>		
Preferred stock, par value \$.01 per share; authorized 50,000,000 shares; zero shares issued or outstanding as of June 30, 2012 and December 31, 2011	0	0
Common stock, par value \$.01 per share; authorized 1,000,000,000 shares; 630,248,839 and 508,594,308 issued as of June 30, 2012 and December 31, 2011, respectively	6	5

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Paid-in capital, net	<b>25,217</b>	19,274
Retained earnings	<b>14,905</b>	13,462
Accumulated other comprehensive income	<b>350</b>	169
Less: Treasury stock, at cost; 49,571,662 and 48,647,091 shares as of June 30, 2012 and December 31, 2011, respectively	<b>(3,286)</b>	(3,244)
<b>Total stockholders equity</b>	<b>37,192</b>	29,666
<b>Total liabilities and stockholders equity</b>	<b>\$ 296,572</b>	\$ 206,019

See Notes to Condensed Consolidated Financial Statements.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

(Dollars in millions, except per share-related data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Interest income:</b>				
Loans held for investment, including past-due fees	\$ 4,255	\$ 3,367	\$ 7,910	\$ 6,784
Investment securities	335	313	633	629
Other	26	19	52	38
<b>Total interest income</b>	<b>4,616</b>	<b>3,699</b>	<b>8,595</b>	<b>7,451</b>
<b>Interest expense:</b>				
Deposits	373	307	684	629
Securitized debt obligations	69	113	149	253
Senior and subordinated notes	87	63	175	127
Other borrowings	86	80	172	166
<b>Total interest expense</b>	<b>615</b>	<b>563</b>	<b>1,180</b>	<b>1,175</b>
Net interest income	4,001	3,136	7,415	6,276
Provision for credit losses	1,677	343	2,250	877
Net interest income after provision for credit losses	2,324	2,793	5,165	5,399
<b>Non-interest income:</b>				
Service charges and other customer-related fees	539	460	954	985
Interchange fees, net	408	331	736	651
Total other-than-temporary losses	(21)	(27)	(25)	(50)
Portion of other-than-temporary losses recorded in AOCI	8	21	(2)	41
Net other-than-temporary impairment losses recognized in earnings	(13)	(6)	(27)	(9)
Bargain purchase gain	0	0	594	0
Other	120	72	318	172
<b>Total non-interest income</b>	<b>1,054</b>	<b>857</b>	<b>2,575</b>	<b>1,799</b>
<b>Non-interest expense:</b>				
Salaries and associate benefits	971	715	1,835	1,456
Marketing	334	329	655	605
Communications and data processing	203	162	375	326
Supplies and equipment	178	124	325	259
Occupancy	145	118	268	237
Merger related	133	0	219	0
Other	1,178	807	1,969	1,534
<b>Total non-interest expense</b>	<b>3,142</b>	<b>2,255</b>	<b>5,646</b>	<b>4,417</b>
Income from continuing operations before income taxes	236	1,395	2,094	2,781
Income tax provision	43	450	396	804



Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Income from continuing operations, net of tax	<b>193</b>	945	<b>1,698</b>	1,977
Loss from discontinued operations, net of tax	<b>(100)</b>	(34)	<b>(202)</b>	(50)
Net income	<b>93</b>	911	<b>1,496</b>	1,927
Dividends and undistributed earnings allocated to participating securities	<b>(1)</b>	0	<b>(8)</b>	0
Net income available to common stockholders	<b>\$ 92</b>	\$ 911	<b>\$ 1,488</b>	\$ 1,927
<b>Basic earnings per common share:</b>				
Income from continuing operations	<b>\$ 0.33</b>	\$ 2.07	<b>\$ 3.11</b>	\$ 4.35
Loss from discontinued operations	<b>(0.17)</b>	(0.07)	<b>(0.37)</b>	(0.11)
Net income per basic common share	<b>\$ 0.16</b>	\$ 2.00	<b>\$ 2.74</b>	\$ 4.24
<b>Diluted earnings per common share:</b>				
Income from continuing operations	<b>\$ 0.33</b>	\$ 2.04	<b>\$ 3.09</b>	\$ 4.29
Loss from discontinued operations	<b>(0.17)</b>	(0.07)	<b>(0.37)</b>	(0.11)
Net income per diluted common share	<b>\$ 0.16</b>	\$ 1.97	<b>\$ 2.72</b>	\$ 4.18
Dividends paid per common share	<b>\$ 0.05</b>	\$ 0.05	<b>\$ 0.10</b>	\$ 0.10

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

## CAPITAL ONE FINANCIAL CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	\$ 93	\$ 911	\$ 1,496	\$ 1,927
Other comprehensive income(loss), net of taxes:				
Unrealized gains on securities, net of tax provision of \$66 million and \$94 million for the three months ended June 30, 2012 and 2011, respectively and \$62 million and \$67 million for the six months ended June 30, 2012 and 2011, respectively	105	172	99	122
Other-than-temporary impairment not recognized in earnings, net of tax benefit of \$2 million for the three months ended June 30, 2011 and net of tax provision of \$21 million and tax benefit of \$4 million for the six months ended June 30, 2012 and 2011, respectively	0	(3)	34	(7)
Defined benefit plans, net of tax benefit of \$2 million for the three months ended June 30, 2012 and \$2 million for the six months ended June 30, 2012	(3)	0	(3)	0
Foreign currency translation adjustments	(44)	4	11	63
Unrealized gains on cash flow hedges, net of tax provision of \$21 million and \$14 million for the three months ended June 30, 2012 and 2011, respectively and \$21 million and \$10 million for the six months ended June 30, 2012 and 2011, respectively	39	24	40	16
Other comprehensive income	97	197	181	194
Comprehensive income	\$ 190	\$ 1,108	\$ 1,677	\$ 2,121

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

## CAPITAL ONE FINANCIAL CORPORATION

## CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(UNAUDITED)

(Dollars in millions, except per share data)	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
	Shares	Amount					
Balance as of December 31, 2011	508,594,308	\$ 5	\$ 19,274	\$ 13,462	\$ 169	\$ (3,244)	\$ 29,666
Comprehensive income				1,496	181		1,677
Cash dividends - common stock \$0.10 per share				(53)			(53)
Purchases of treasury stock						(42)	(42)
Issuances of common stock and restricted stock, net of forfeitures	66,791,991		3,200				3,200
Exercise of stock options and tax benefits of exercises and restricted stock vesting	834,454		45				45
Compensation expense for restricted stock awards and stock options			61				61
Issuance of common stock related to acquisition	54,028,086	1	2,637				2,638
<b>Balance as of June 30, 2012</b>	<b>630,248,839</b>	<b>\$ 6</b>	<b>\$ 25,217</b>	<b>\$ 14,905</b>	<b>\$ 350</b>	<b>\$ (3,286)</b>	<b>\$ 37,192</b>

See Notes to Condensed Consolidated Financial Statements.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(Dollars in millions)	Six Months Ended June 30,	
	2012	2011
<b>Operating activities:</b>		
Income from continuing operations, net of tax	\$ 1,698	\$ 1,977
Loss from discontinued operations, net of tax	(202)	(50)
Net income	1,496	1,927
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for credit losses	2,250	877
Depreciation and amortization, net	692	299
Net gains on sales of securities available for sale	(41)	(11)
Impairment loss on securities available for sale	6	0
Bargain purchase gain	(594)	0
Loans held for sale:		
Originations/Transfers in	(1,813)	(209)
(Gains) losses on sales	(29)	23
Proceeds from sales	996	334
Stock plan compensation expense	116	117
Changes in operating assets and liabilities, net of effects of acquisitions		
(Increase) decrease in interest receivable	(424)	43
(Increase) decrease in accounts receivable from securitizations	(2)	12
Decrease in other assets	24	792
Decrease in interest payable	(4)	(19)
Decrease in other liabilities	458	127
Net cash provided by operating activities attributable to discontinued operations	21	49
Net cash provided by operating activities	3,152	4,361
<b>Investing activities:</b>		
Increase in restricted cash for securitization investors	421	274
Purchases of securities available for sale	(9,095)	(5,085)
Proceeds from paydowns and maturities of securities available for sale	8,651	4,715
Proceeds from sales of securities available for sale	14,258	2,570
Net decrease in loans held for investment	(638)	(4,474)
Principal recoveries of loans previously charged off	768	826
Additions of premises and equipment	(262)	(159)
Net cash payment for companies acquired, net of cash received	(17,603)	(1,444)
Net cash used in investing activities	(3,500)	(2,777)
<b>Financing activities:</b>		
Net increase in deposits	1,279	3,907
Net decrease in securitized debt obligations	(2,919)	(7,055)
Net increase (decrease) in other borrowings	(1,989)	2,983
Maturities of senior notes	(282)	0
Issuance of senior and subordinated notes and junior subordinated debentures	1,250	0
Purchases of treasury stock	(42)	(39)
Dividends paid on common stock	(53)	(46)

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Net proceeds from issuances of common stock	3,200	18
Proceeds from share-based payment activities	45	42
Net cash provided by (used in) financing activities	489	(190)
Increase in cash and cash equivalents	141	1,394
Cash and cash equivalents at beginning of the period	5,838	5,249
Cash and cash equivalents at end of the period	\$ 5,979	\$ 6,643

**Supplemental cash flow information:**

Non-cash items:

Excess of the net fair value of assets acquired over consideration transferred for acquired businesses	\$ (322)	\$ 3
--	----------	------

See Notes to Condensed Consolidated Financial Statements.

---

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**The Company**

Capital One Financial Corporation, which was established in 1995, is a diversified financial services holding company headquartered in McLean, Virginia. Capital One Financial Corporation and its subsidiaries (the Company) offer a broad array of financial products and services to consumers, small businesses and commercial clients through branches, the internet and other distribution channels. Our principal subsidiaries include Capital One Bank (USA), National Association (COBNA), Capital One, National Association (CONA) and ING Bank, fsb. The Company and its subsidiaries are hereafter collectively referred to as we, us or our. CONA and COBNA are hereafter collectively referred to as the Banks. As one of the 10 largest banks in the United States based on deposits, we serve banking customers across the U.S. through the internet and through branch locations primarily in New York, New Jersey, Texas, Louisiana, Maryland, Virginia and the District of Columbia. In addition to bank lending and depository services, we offer credit and debit card products, mortgage banking and treasury management services. We offer our products outside of the United States principally through operations in the United Kingdom and Canada.

In 2011, we entered into a purchase and sale agreement with ING Groep N.V., ING Bank N.V., ING Direct N.V., ING Direct Bancorp (collectively, the ING Sellers), under which we would acquire substantially all of the ING Sellers' ING Direct business in the United States (ING Direct). On February 17, 2012, we closed the acquisition of ING Direct, which included (i) the acquisition of all the equity interests of ING Bank, fsb, (ii) the acquisition of all the equity interests of each of WS Realty, LLC and ING Direct Community Development LLC and (iii) the acquisition of certain other assets and the assumption of certain other liabilities of ING Direct Bancorp. See Note 2 Acquisitions for additional information related to the ING Direct acquisition.

On May 1, 2012, we completed the previously announced acquisition of assets and the assumption of liabilities of the credit card and private label credit card business in the United States (other than the HSBC Bank USA, National Association consumer credit card program and certain other retained assets and liabilities) of HSBC Finance Corporation, HSBC USA Inc. and HSBC Technology & Services (USA) Inc. (collectively, the HSBC Sellers). See Note 2 Acquisitions for additional information related to the HSBC U.S. Card acquisition.

Our principal operations are organized into three primary business segments, which are defined based on the products and services provided, or the type of customer served: Credit Card, Consumer Banking and Commercial Banking. In the first quarter of 2012, we re-aligned the reporting of our Commercial Banking business to reflect the operations on a product basis rather than by customer type (See Note 14 Business Segments for additional information).

**Basis of Presentation and Use of Estimates**

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and should be read in conjunction with the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2011 (2011 Form 10-K). Certain financial information that is normally included in annual financial statements prepared in conformity with U.S. GAAP, but is not required for interim reporting purposes, has been condensed or omitted. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of our interim unaudited financial statements have been reflected.

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related disclosures. These estimates are based on information available as of the date of the consolidated financial statements. While management makes its best judgment, actual amounts or results could differ from these estimates. Interim period results may not be indicative of results for the full year.

**Principles of Consolidation**

The unaudited condensed consolidated financial statements include the accounts of Capital One Financial Corporation and all other entities in which we have a controlling financial interest. All significant intercompany accounts and transactions have been eliminated. Certain prior period amounts have been reclassified to conform to the current period presentation.

**Significant Accounting Policies**

We provide a summary of our significant accounting policies in our 2011 Form 10-K under Notes to Consolidated Statements Note 1 Summary of Significant Accounting Policies. Below we describe accounting standards that we adopted in 2012 and recently issued accounting standards that we have not yet adopted.

***Accounting Standards Adopted in 2012***

***Goodwill Impairment***

In September 2011, the Financial Accounting Standards Board ( FASB ) issued guidance that is intended to simplify goodwill impairment testing by providing entities with the option to first assess qualitatively whether it is necessary to perform the two-step quantitative analysis currently required. If an entity chooses to perform a qualitative assessment and determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative two-step goodwill impairment test is required. Otherwise, goodwill is deemed to be not impaired and no further analysis would be necessary. The amended goodwill impairment guidance does not affect the manner in which a company estimates fair value. The amended guidance was effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We adopted the amended guidance on January 1, 2012. We had \$13.9 billion in goodwill as of June 30, 2012, the value of which was not affected by the adoption of this standard.

***Presentation of Comprehensive Income***

In June 2011, the FASB issued new accounting guidance that revises the manner in which comprehensive income is required to be presented in financial statements. The new guidance requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. The guidance eliminates the option to present components of other comprehensive income in the statement of changes in stockholders' equity. It does not change the items which must be reported in other comprehensive income, how such items are measured or when they must be reclassified from other comprehensive income to net income. The guidance requires retrospective application and was effective for interim and annual periods beginning on or after December 15, 2011. We adopted the guidance in the first quarter of 2012 and elected to present other comprehensive income in a separate statement immediately following our consolidated statement of income. Our adoption of the guidance had no effect on our financial condition, results of operations or liquidity since it impacts presentation only.

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

*Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ( IFRS )*

In May 2011, the FASB issued amended guidance on fair value that is intended to provide a converged fair value framework for U.S. GAAP and IFRS. While the amended guidance continues to define fair value as an exit price, it changes some fair value measurement principles and expands the existing disclosure requirements for fair value measurements. The amended guidance was effective for public entities during interim and annual periods beginning after December 15, 2011, with early adoption prohibited. The new guidance requires prospective application and disclosure in the period of adoption of the change, if any, in valuation techniques and related inputs resulting from application of the amendments and quantification of the total effect, if practicable. We adopted the amended guidance in the first quarter of 2012. The change in fair value measurement principles did not result in any changes to the fair value of our assets or liabilities carried at fair value and thus, had no effect on our financial condition, results of operations or liquidity. The new disclosures required by the amended guidance are included in Note 13 Fair Value of Financial Instruments.

*Transfers and Servicing: Reconsideration of Effective Control for Repurchase Agreements*

In April 2011, the FASB issued an amendment to the guidance for transfers and servicing with regard to repurchase agreements and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. This amendment removes the criterion related to collateral maintenance from the transferor's assessment of effective control. It focuses the assessment of effective control on the transferor's rights and obligations with respect to the transferred financial assets and not whether the transferor has the practical ability to perform in accordance with those rights or obligations. We adopted the amended guidance on January 1, 2012, which did not have a material impact on our consolidated financial statements.

***Recently Issued but Not Yet Adopted Accounting Standards***

*Offsetting Financial Assets and Liabilities*

In December 2011, the FASB issued guidance intended to enhance current disclosure requirements on offsetting financial assets and liabilities. The new disclosures will enable financial statement users to compare balance sheets prepared under U.S. GAAP and IFRS, which are subject to different offsetting models. Upon adoption, entities will be required to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions subject to an agreement similar to a master netting arrangement. The disclosures will be required irrespective of whether such instruments are presented gross or net on the balance sheet. The guidance is effective for annual and interim reporting periods beginning on or after January 1, 2013, with comparative retrospective disclosures required for all periods presented. Our adoption of the guidance will have no effect on our financial condition, results of operations or liquidity since it impacts disclosures only.

**NOTE 2 ACQUISITIONS**

We regularly explore opportunities to enter into strategic partnership agreements or acquire financial services companies, businesses and portfolios to expand our distribution channels, enhance our businesses and grow our customer base. We may structure these transactions with both an initial payment and later contingent payments tied to future financial performance. In some partnership agreements, we may enter into collaborative risk-sharing arrangements that provide for revenue and loss sharing. We provide information on our accounting for acquisitions and partnership agreements in Note 2 Acquisitions and Restructuring Activities of our 2011 Form 10-K.





**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**2012 Acquisitions**

***ING Direct***

On June 16, 2011, we entered into a purchase and sale agreement with ING Sellers, under which we would acquire ING Direct. On February 17, 2012, we closed the acquisition of ING Direct, which included (i) the acquisition of all the equity interests of ING Bank, fsb (ii) the acquisition of all equity interests of each of WS Realty LLC and ING Direct Community Development LLC and (iii) the acquisition of certain other assets and the assumption of certain other liabilities of ING Direct Bancorp. Headquartered in Wilmington, Delaware, ING Direct is the largest direct bank in the United States. The ING Direct acquisition strengthens our customer franchise and adds over seven million customers and approximately \$84.4 billion in deposits to our Consumer Banking segment.

The aggregate consideration paid by us in the ING Direct acquisition was approximately \$6.3 billion in cash and 54,028,086 shares of Capital One common stock with a fair value of approximately \$2.6 billion as of the acquisition date of February 17, 2012. We used current liquidity sources as well as proceeds from public debt and equity offerings described below to fund the cash consideration.

In the third quarter of 2011, we closed a public offering of four different series of our senior notes for total cash proceeds of approximately \$3.0 billion and a public underwritten offering of 40 million shares of our common stock, subject to forward sale agreements. We settled the forward sale agreements entirely by physical delivery of shares of common stock in exchange for cash proceeds from the forward purchasers of approximately \$1.9 billion on February 16, 2012.

We also incurred transaction costs related to the ING Direct acquisition totaling \$62 million as of March 31, 2012, of which \$25 million was recognized in 2011 and \$37 million was recognized in the first quarter of 2012 and reported in our consolidated statement of income as a component of non-interest expense. These transaction costs do not include other merger-related expenses, such as integration costs.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)***Accounting for ING Direct Acquisition*

The ING Direct acquisition was accounted for under the acquisition method of accounting, which requires, among other things, that we allocate the purchase price to the assets acquired and liabilities assumed based on their fair values as of the acquisition date. The following table summarizes our allocation of the ING Direct purchase price to the fair value of assets acquired and liabilities assumed.

(Dollars in millions)	Fair Value
<b>Purchase price:</b>	
Cash	\$ 6,321
Fair value of Capital One common stock issued (54,028,086 shares)	2,638
Aggregate consideration transferred	\$ 8,959
<b>Allocation of purchase price to net assets acquired:</b>	
Assets:	
Cash and due from banks	\$ 20,061
Investments	30,237
Loans held for investment	40,042
Loans held for sale	367
Premises and equipment	245
Accrued interest receivable <sup>(1)</sup>	170
Identifiable intangible assets	358
Other assets <sup>(2)</sup>	2,854
<b>Total assets</b>	<b>94,334</b>
Liabilities:	
Interest payable	31
Interest-bearing deposits	84,410
Other borrowings	6
Other liabilities <sup>(3)</sup>	334
<b>Total liabilities</b>	<b>84,781</b>
Net assets acquired	9,553
Bargain purchase gain	\$ 594

<sup>(1)</sup> Includes \$79 million of accrued interest receivable attributable to loans held for investment.

<sup>(2)</sup> Other assets include \$801 million of deferred tax assets, net of a valuation allowance of \$8 million, as of the acquisition date.

<sup>(3)</sup> Other liabilities include \$181 million of deferred tax liabilities as of the acquisition date.

At acquisition, the fair value of the net assets acquired from ING Direct of \$9.6 billion exceeded the purchase price of \$9.0 billion, resulting in the recognition of a bargain purchase gain of \$594 million, which was reported as a component of non-interest income on our consolidated statement of income for the first quarter of 2012. A substantial portion of the assets acquired from ING Direct were mortgage-related assets, which generally decrease in value as interest rates rise and increase in value as interest rates fall. The bargain purchase gain was driven largely

by a substantial decline in long-term interest rates between the period shortly after our announcement of the ING Direct acquisition and its closing, which resulted in an increase in the fair value of the acquired mortgage assets and the overall net fair value of assets acquired. Further, the purchase and sale agreement did not include a mechanism to adjust the purchase price to reflect the increase to the fair value of the net assets acquired.

---

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)*****HSBC U.S. Card Business Acquisition***

On May 1, 2012, Capital One completed the previously announced acquisition of assets and assumption of liabilities of the credit card and private label credit card business in the United States (other than the HSBC Bank USA, National Association consumer credit card program and certain other retained assets and liabilities) of HSBC Finance Corporation, HSBC USA Inc. and HSBC Technology & Services (USA) Inc. (collectively, the HSBC Sellers), pursuant to the Purchase and Assumption Agreement, dated as of August 10, 2011 by and among Capital One and each of the HSBC Sellers (the HSBC U.S. card acquisition). We acquired approximately \$28.3 billion of outstanding credit card receivables as well as \$327 million in other net assets in exchange for consideration of approximately \$31.1 billion in cash to the HSBC sellers, net of a \$252 million receivable. We financed the acquisition through a combination of existing cash, cash acquired from the ING Direct acquisition, the sale of securities held as available-for-sale, as well as the public debt and equity offerings described below. The HSBC U.S. card acquisition enhances the existing franchise and scale in the Domestic Card business and accelerates our achievement of a leading position in retail credit card partnerships.

In the first quarter of 2012, we closed a public offering of 24,442,706 shares of our common stock which we sold to the underwriters at a per share price of \$51.14 for net proceeds of approximately \$1.25 billion. In addition, we issued \$1.25 billion of our senior notes due 2015 in a public offering which also closed in the first quarter for net proceeds of approximately \$1.25 billion. Direct costs of approximately \$2 million paid to third parties in connection with this debt issuance were capitalized as deferred charges in the balance sheet and are amortized over the term of the debt as a component of interest expense using the effective interest method.

We also incurred transaction costs related to the HSBC U.S. card acquisition totaling \$40 million as of June 30, 2012. \$3 million was recognized as part of non-interest expense in the 2011 consolidated statement of income. The remaining \$37 million is included in our current consolidated statement of income as a component of non-interest expenses. These costs do not include other merger-related expenses such as integration costs.

***Accounting for the HSBC U.S. Card Acquisition***

The HSBC U.S. card acquisition was accounted for under the acquisition method of accounting, which requires, among other things, that we allocate the purchase price to the assets acquired and liabilities assumed based on their fair values as of the acquisition date. The following table summarizes the initial accounting for the HSBC U.S. card acquisition which is based on provisional estimates given the limited time between the acquisition date and the issuance of these financial statements. We will finalize the accounting for intangible assets acquired and other liabilities assumed in the HSBC U.S. card acquisition during the measurement period. Immaterial adjustments to these items as presented below may be necessary and may have an immaterial impact on the amount of goodwill recognized. Based on the initial accounting estimates presented below, the purchase price of assets acquired and liabilities assumed exceeded the fair value of these items and resulted in the recognition of \$272 million of goodwill which is assigned to the Credit Card segment. Goodwill results from expertise gained through an enhanced retail partnership business as well as economies of scale obtained through infrastructure enhancements and additions to our current staff. For tax reporting purposes, the HSBC U.S. card acquisition is treated a taxable purchase of assets. As such, the total amount of goodwill recognized is amortizable for tax purposes over 15 years.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	Fair Value
<b>Purchase price:</b>	
Cash	\$ 31,343
Receivable due from HSBC	(252)
 Total consideration transferred	 \$ 31,091
<b>Allocation of purchase price to net assets acquired:</b>	
Assets:	
Loans receivable <sup>(1)</sup>	\$ 28,234
Other assets	378
Premises and equipment	502
Intangible assets	2,213
 Total assets	 31,327
Liabilities:	
Other liabilities	508
 Total liabilities	 508
 Net assets acquired	 30,819
 Goodwill	 \$ 272

<sup>(1)</sup> Loans receivable includes the fair value of unpaid principal balances of loans, the associated accrued interest and balances in certain loan settlement accounts.

*ING Direct and HSBC U.S. Card Results*

Our results for the second quarter and first six months of 2012 include the operations of ING Direct from the acquisition date of February 17, 2012, through June 30, 2012 and the operations of the acquired HSBC U.S. card business from the acquisition date of May 1, 2012 through June 30, 2012.

The tables below present the estimated impact of the ING Direct acquisition and the HSBC U.S. card acquisition on our revenue and income from continuing operations, net of tax for the second quarter and first six months of 2012. The table also includes condensed pro forma information on our combined results of operations as they may have appeared assuming the ING Direct acquisition and HSBC U.S. card acquisitions had been completed on January 1, 2011. These amounts do not include certain corporate expenses, transaction costs, or merger-related expenses that resulted from the two acquisitions and are therefore not representative of the actual results of the operations of these businesses on a stand-alone basis. As we continue to integrate these businesses into our existing operations over the remainder of the year, it may become impracticable to separately identify and to estimate these operating results.

Because the HSBC U.S. card acquisition did not involve the acquisition of an entire legal entity, we were not able to develop a complete income statement for the current reporting period. To determine the amounts provided below, we relied on historical HSBC management reports. Corporate expenses, such as salary expenses, fixed asset depreciation, and intangible asset amortization were estimated and allocated based on the total amount of these expenses as of December 31, 2011. Also included in the combined pro forma results are adjustments to reflect the impact of amortizing certain purchase accounting adjustments, such as the amortization of intangible assets and the accretion of interest income on certain acquired loans. Because the bargain purchase gain recognized in the ING Direct acquisition is a nonrecurring item, it is excluded from

the pro forma results to present the information on a more comparative basis.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The pro forma condensed combined financial information is presented for illustrative purposes only and does not indicate the actual combined financial results had the closing of the ING Direct acquisition or the HSBC U.S. card acquisition been completed on January 1, 2011 nor does it reflect the benefits obtained through the integration of business operations realized since acquisition. Furthermore, the information is not indicative of the results of operations in future periods. The pro forma condensed combined financial information does not reflect the impact of possible business model changes nor does it consider any potential impacts of market conditions, expense efficiencies or other factors.

(Dollars in millions)	ING Direct	HSBC	Combined	
	Impact	Impact	Pro Forma	
	Three Months	From	Results	
	Ended	May 1,	Three Months Ended	
	June 30, 2012	2012	2012	2011
		through	June 30,	June 30,
		June 30, 2012	2012	2011
Revenue <sup>(1)</sup>	\$ 512	\$ 733	\$ 6,093	\$ 6,095
Income from continuing operations, net of tax	126	(545)	176	1,145

(Dollars in millions)	ING Direct	HSBC	Combined	
	Impact	Impact	Pro Forma	
	From February 17,	From	Results	
	2012 through	May 1,	Six Months Ended	
	June 30, 2012	2012	2012	2011
		through	June 30,	June 30,
		June 30, 2012	2012	2011
Revenue <sup>(1)</sup>	\$ 749	\$ 733	\$ 12,418	\$ 12,970
Income from continuing operations, net of tax	163	(545)	1,695	2,521

<sup>(1)</sup> The amounts reported consist of gross interest income and gross non-interest income. Net revenue for ING Direct was \$348 million for the three months ended June 30, 2012 and \$503 from acquisition on February 17, 2012 through June 30, 2012. Net revenue for HSBC from acquisition on May 1, 2012 through June 30, 2012 was \$663 million. Net revenue includes interest income, non-interest income and interest expense.

**NOTE 3 DISCONTINUED OPERATIONS****Shutdown of Mortgage Origination Operations of Wholesale Mortgage Banking Unit**

In the third quarter of 2007, we closed the mortgage origination operations of our wholesale mortgage banking unit, acquired by us in December 2006 as part of the North Fork acquisition. The results of the mortgage origination operations of our wholesale mortgage banking unit have been accounted for as a discontinued operation and therefore not included in our results from continuing operations for the three and six months ended June 30, 2012 and 2011. We have no significant continuing involvement in these operations.



## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

The following table summarizes the results from discontinued operations related to the closure of our wholesale mortgage banking unit:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net interest expense	\$ 0	\$ 0	\$ 0	\$ 0
Non-interest expense	(160)	(53)	(321)	(78)
Loss from discontinued operations before taxes	(160)	(53)	(321)	(78)
Income tax benefit	(60)	(19)	(119)	(28)
Loss from discontinued operations, net of taxes	\$ (100)	\$ (34)	\$ (202)	\$ (50)

---

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The loss from discontinued operations includes an expense of \$154 million (\$97 million net of tax) and \$307 million (\$194 million net of tax) for the three and six months ended June 30, 2012, respectively, and an expense of \$33 million (\$22 million net of tax) and \$72 million (\$51 million net of tax) for the three and six months ended June 30, 2011, respectively, attributable to provisions for mortgage loan repurchase losses related to representations and warranties provided on loans previously sold to third parties by the wholesale banking unit. The increase in the provision for mortgage loan repurchase losses was largely driven by updated estimates of anticipated outcomes from various litigation and threatened litigation in the insured securitization segment based on relevant factual and legal developments and an increased reserve associated with a first quarter settlement between a subsidiary and a GSE to resolve present and future repurchase claims.

The discontinued mortgage origination operations of our wholesale mortgage banking unit had remaining assets, which consisted primarily of income tax receivables, of \$310 million and \$304 million as of June 30, 2012 and December 31, 2011, respectively. Liabilities totaled \$706 million and \$680 million as of June 30, 2012 and December 31, 2011, respectively, consisting primarily of reserves for representations and warranties on loans previously sold to third parties.

**NOTE 4 INVESTMENT SECURITIES**

Our investment securities portfolio, which had a fair value of \$55.3 billion and \$38.8 billion, as of June 30, 2012 and December 31, 2011, respectively, consists of U.S. Treasury and U.S. agency debt obligations; agency and non-agency mortgage-backed securities; asset-backed securities collateralized primarily by credit card loans, auto loans, student loans, auto dealer floor plan inventory loans, equipment loans, commercial paper, and home equity lines of credit; municipal securities; foreign government/agency bonds; covered bonds; and Community Reinvestment Act (CRA) equity securities. Our investment securities increased by \$16.5 billion, or 43%, in the first six months of 2012 which was primarily attributable to the acquisition of ING Direct which included investment securities of \$30.2 billion at acquisition offset by a sale of approximately \$14.3 billion investment securities. Our investment securities portfolio continues to be concentrated in securities that generally have lower credit risk and high credit ratings, such as securities issued and guaranteed by the U.S. Treasury and government sponsored enterprises or agencies. Our investments in U.S. Treasury, agency securities and other securities guaranteed by the U.S. Government, based on fair value, represented 68% of our total investment securities portfolio as of June 30, 2012, compared with 69% as of December 31, 2011.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Securities Amortized Cost and Fair Value**

All of our investment securities were classified as available-for-sale as of June 30, 2012 and December 31, 2011, and are reported in our consolidated balance sheet at fair value. The following tables present the amortized cost, fair values and corresponding gross unrealized gains (losses), by major security type, for our investment securities as of June 30, 2012 and December 31, 2011. The gross unrealized gains (losses) related to our available-for-sale securities are recorded, net of tax, as a component of accumulated other comprehensive income ( AOCI ).

(Dollars in millions)	June 30, 2012					Fair Value
	Amortized Cost	Total Gross Unrealized Gains	Gross Unrealized Losses- OTTI <sup>(1)</sup>	Gross Unrealized Losses- Other <sup>(2)</sup>	Total Gross Unrealized Losses	
<b>Securities available for sale:</b>						
U.S. Treasury debt obligations	\$ 1,559	\$ 3	\$ 0	\$ 0	\$ 0	\$ 1,562
U.S. Agency debt obligations <sup>(3)</sup>	381	8	0	(1)	(1)	388
Residential mortgage-backed securities( RMBS ):						
Agency <sup>(4)</sup>	30,013	629	0	(26)	(26)	30,616
Non-agency	3,800	41	(116)	(54)	(170)	3,671
<b>Total RMBS</b>	<b>33,813</b>	<b>670</b>	<b>(116)</b>	<b>(80)</b>	<b>(196)</b>	<b>34,287</b>
Commercial mortgage-backed securities ( CMBS ):						
Agency <sup>(4)</sup>	4,740	71	0	0	0	4,811
Non-agency	1,264	35	0	(1)	(1)	1,298
<b>Total CMBS</b>	<b>6,004</b>	<b>106</b>	<b>0</b>	<b>(1)</b>	<b>(1)</b>	<b>6,109</b>
Asset-backed securities ( ABS <sup>(5)</sup> )	11,646	56	0	(13)	(13)	11,689
Other <sup>(6)</sup>	1,219	37	0	(2)	(2)	1,254
<b>Total securities available for sale</b>	<b>\$ 54,622</b>	<b>\$ 880</b>	<b>\$ (116)</b>	<b>\$ (97)</b>	<b>\$ (213)</b>	<b>\$ 55,289</b>

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	December 31, 2011					
	Amortized Cost	Total Gross Unrealized Gains	Gross Unrealized Losses- OTTI <sup>(1)</sup>	Gross Unrealized Losses- Other <sup>(2)</sup>	Total Gross Unrealized Losses	Fair Value
<b>Securities available for sale:</b>						
U.S. Treasury debt obligations	\$ 115	\$ 9	\$ 0	\$ 0	\$ 0	\$ 124
U.S. Agency debt obligations <sup>(3)</sup>	131	7	0	0	0	138
Residential mortgage-backed securities ( RMBS ):						
Agency <sup>(4)</sup>	24,980	539	0	(31)	(31)	25,488
Non-agency	1,340	1	(170)	(9)	(179)	1,162
<b>Total RMBS</b>	<b>26,320</b>	<b>540</b>	<b>(170)</b>	<b>(40)</b>	<b>(210)</b>	<b>26,650</b>
Commercial mortgage-backed securities ( CMBS ):						
Agency <sup>(4)</sup>	697	14	0	0	0	711
Non-agency	459	17	0	0	0	476
<b>Total CMBS</b>	<b>1,156</b>	<b>31</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>1,187</b>
Asset-backed securities ( ABS <sup>(5)</sup> )	10,119	45	0	(14)	(14)	10,150
Other <sup>(6)</sup>	462	51	0	(3)	(3)	510
<b>Total securities available for sale</b>	<b>\$ 38,303</b>	<b>\$ 683</b>	<b>\$ (170)</b>	<b>\$ (57)</b>	<b>\$ (227)</b>	<b>\$ 38,759</b>

(1) Represents the amount of cumulative non-credit other-than-temporary impairment ( OTTI ) losses recorded in AOCI. These losses are included in total gross unrealized losses.

(2) Represents the amount of cumulative gross unrealized losses on securities for which we have not recognized OTTI.

(3) Consists of debt securities issued by Fannie Mae and Freddie Mac, which had an amortized cost of \$130 million as of June 30, 2012 and December 31, 2011, respectively, and fair value of \$135 million and \$137 million, as of both June 30, 2012 and December 31, 2011. The remaining balance consists of debt that is guaranteed by the U.S. Government.

(4) Consists of MBS issued by Fannie Mae, Freddie Mac and Ginnie Mae with an amortized cost of \$15.1 billion, \$10.3 billion and \$9.4 billion and \$12.3 billion, \$8.9 billion and \$4.5 billion, as of June 30, 2012 and December 31, 2011, respectively, and fair value of \$15.4 billion, \$10.5 billion and \$9.5 billion and \$12.6 billion, \$9.1 billion and \$4.5 billion, as of June 30, 2012 and December 31, 2011, respectively. The book value of Fannie Mae, Freddie Mac and Ginnie Mae investments individually exceeded 10% of our stockholders' equity as of June 30, 2012 and December 31, 2011.

(5) Consists of securities collateralized by credit card loans, auto dealer floor plan inventory loans and leases, auto loans, student loans, equipment loans, and other. The distribution among these asset types was approximately 73% credit card loans, 13% auto dealer floor plan inventory loans and leases, 6% auto loans, 1% student loans, 2% equipment loans, 2% commercial paper, and 3% other as of June 30, 2012. In comparison, the distribution was approximately 75% credit card loans, 11% auto dealer floor plan inventory loans and leases, 6% auto loans, 4% student loans, 2% equipment loans, and 2% other as of December 31, 2011. Approximately 85% of the securities in our asset-backed security portfolio were rated AAA or its equivalent as of June 30, 2012, compared with 86% as of December 31, 2011.

(6) Consists of foreign government/agency bonds, covered bonds, municipal securities and equity investments, primarily related to CRA activities.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Securities Available for Sale in a Gross Unrealized Loss Position**

The table below provides, by major security type, information about our available-for-sale securities in a gross unrealized loss position and the length of time that individual securities have been in a continuous unrealized loss position as of June 30, 2012 and December 31, 2011.

(Dollars in millions)	Less than 12 Months		June 30, 2012 12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>Securities available for sale:</b>						
US Treasury Debt Obligations	\$ 69	\$ (1)	\$ 0	\$ 0	\$ 69	\$ (1)
<b>RMBS:</b>						
Agency <sup>(1)</sup>	3,545	(25)	377	(1)	3,922	(26)
Non-agency	1,243	(64)	1,001	(106)	2,244	(170)
<b>Total RMBS</b>	<b>4,788</b>	<b>(89)</b>	<b>1,378</b>	<b>(107)</b>	<b>6,166</b>	<b>(196)</b>
<b>CMBS:</b>						
Agency <sup>(1)</sup>	14	0	0	0	14	0
Non-agency	224	(1)	0	0	224	(1)
<b>Total CMBS</b>	<b>238</b>	<b>(1)</b>	<b>0</b>	<b>0</b>	<b>238</b>	<b>(1)</b>
<b>Total ABS</b>	<b>1,387</b>	<b>(2)</b>	<b>237</b>	<b>(11)</b>	<b>1,624</b>	<b>(13)</b>
Other	335	(1)	32	(1)	367	(2)
<b>Total securities available-for-sale in a gross unrealized loss position</b>	<b>\$ 6,817</b>	<b>\$ (94)</b>	<b>\$ 1,647</b>	<b>\$ (119)</b>	<b>\$ 8,464</b>	<b>\$ (213)</b>

(Dollars in millions)	Less than 12 Months		December 31, 2011 12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>Securities available for sale:</b>						
<b>RMBS:</b>						
Agency <sup>(1)</sup>	\$ 4,731	\$ (30)	\$ 334	\$ (1)	\$ 5,065	\$ (31)
Non-agency	151	(17)	986	(162)	1,137	(179)
<b>Total RMBS</b>	<b>4,882</b>	<b>(47)</b>	<b>1,320</b>	<b>(163)</b>	<b>6,202</b>	<b>(210)</b>
<b>CMBS:</b>						
Agency <sup>(1)</sup>	100	0	0	0	100	0

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Non-agency	67	0	0	0	67	0
Total CMBS	167	0	0	0	167	0
Total ABS	2,084	(11)	81	(3)	2,165	(14)
Other	198	0	85	(3)	283	(3)
Total securities available-for-sale in a gross unrealized loss position	\$ 7,331	\$ (58)	\$ 1,486	\$ (169)	\$ 8,817	\$ (227)

<sup>(1)</sup> Consists of mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The gross unrealized losses on our available-for-sale securities of \$213 million as of June 30, 2012 relate to 776 individual securities. Our investments in non-agency MBS and non-agency asset-backed securities accounted for \$184 million, or 87%, of total gross unrealized losses as of June 30, 2012. Of the \$213 million gross unrealized losses as of June 30, 2012, \$119 million related to securities that had been in a loss position for more than 12 months. We conduct periodic reviews of all securities with unrealized losses to assess whether the impairment is other-than-temporary. Based on our assessments, we have recorded OTTI for a portion of our non-agency residential MBS, which is discussed in more detail later in this footnote.

**Maturities and Yields of Securities Available for Sale**

The following table summarizes the remaining scheduled contractual maturities, assuming no prepayments, of our investment securities as of June 30, 2012:

(Dollars in millions)	June 30, 2012	
	Amortized Cost	Fair Value
Due in 1 year or less	\$ 5,639	\$ 5,653
Due after 1 year through 5 years	8,363	8,397
Due after 5 years through 10 years	3,114	3,205
Due after 10 years <sup>(1)</sup>	37,506	38,034
<b>Total</b>	<b>\$ 54,622</b>	<b>\$ 55,289</b>

<sup>(1)</sup> Investments with no stated maturities, which consist of equity securities, are included with contractual maturities due after 10 years.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

Because borrowers may have the right to call or prepay certain obligations, the expected maturities of our securities are likely to differ from the scheduled contractual maturities presented above. The table below summarizes, by major security type, the expected maturities and the weighted average yields of our investment securities as of June 30, 2012. Actual calls or prepayment rates may differ from our estimates, which may cause the actual maturities of our investment securities to differ from the expected maturities presented below.

(Dollars in millions)	June 30, 2012									
	Due in 1 Year or Less		Due > 1 Year through 5 Years		Due > 5 Years through 10 Years		Due > 10 Years		Total	
	Amount	Average Yield <sup>(1)</sup>	Amount	Average Yield <sup>(1)</sup>	Amount	Average Yield <sup>(1)</sup>	Amount	Average Yield <sup>(1)</sup>	Amount	Average Yield <sup>(1)</sup>
<b>Fair value of securities available for sale:</b>										
U.S. Treasury debt obligations	\$ 706	0.21%	\$ 856	0.50%	\$ 0	0%	\$ 0	0%	\$ 1,562	0.37%
U.S. Agency debt obligations <sup>(2)</sup>	30	4.43	132	4.38	211	2.06	15	3.48	388	3.07
RMBS:										
Agency <sup>(3)</sup>	1,511	3.86	22,733	2.88	6,219	2.70	153	3.35	30,616	2.90
Non-agency	188	6.45	1,659	8.15	1,725	7.52	99	7.68	3,671	7.76
Total RMBS	1,699	4.15	24,392	3.26	7,944	3.80	252	5.21	34,287	3.44
CMBS:										
Agency <sup>(3)</sup>	131	2.50	3,330	1.74	1,350	2.46	0	0	4,811	1.96
Non-agency	354	3.50	362	4.01	582	3.63	0	0	1,298	3.70
Total CMBS	485	3.23	3,692	1.96	1,932	2.81	0	0	6,109	2.32
Total ABS	4,856	1.94	6,381	1.14	363	3.63	89	6.79	11,689	1.59
Other <sup>(4)</sup>	404	1.25	709	1.21	1	6.89	140	0.04	1,254	1.12
Total securities available for sale	\$ 8,180	2.30%	\$ 36,162	2.65%	\$ 10,451	3.58%	\$ 496	4.25%	\$ 55,289	2.78%
<b>Amortized cost of securities available-for-sale</b>										
	\$ 8,165		\$ 35,679		\$ 10,317		\$ 461		\$ 54,622	

(1) Average yields are calculated based on the amortized cost of each security.

(2) Consists of debt securities issued by Fannie Mae, Freddie Mac and other investments which are guaranteed by the U.S. Government.

(3) Consists of mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae.

(4) Yields of tax-exempt securities are calculated on a fully taxable-equivalent (FTE) basis.

**Other-Than-Temporary Impairment**

We evaluate all securities in an unrealized loss position at least quarterly, and more often as market conditions require, to assess whether the impairment is other-than-temporary. Our OTTI assessment is a subjective process requiring the use of judgments and assumptions. Accordingly, we consider a number of qualitative and quantitative criteria in our assessment, including the extent and duration of the impairment; recent events specific to the issuer and/or industry to which the issuer belongs; the payment structure of the security; external credit ratings and the failure of the issuer to make scheduled interest or principal payments; the value of underlying collateral; our intent and ability to hold the



security; and current market conditions.

Table of Contents

## CAPITAL ONE FINANCIAL CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

We assess, measure, and recognize OTTI in accordance with the accounting guidance for recognition and presentation of OTTI. Under this guidance, if we determine that impairment on our debt securities is other-than-temporary and we have made the decision to sell the security, or it is more likely than not that we will be required to sell the security prior to recovery of its amortized cost basis, we recognize the entire portion of the impairment in earnings. If we have not made a decision to sell the security and we do not expect that we will be required to sell the security prior to recovery of the amortized cost basis, we recognize only the credit component of OTTI in earnings. The remaining unrealized loss due to factors other than credit, or the non-credit component, is recorded in AOCI. We determine the credit component based on the difference between the security's amortized cost basis and the present value of its expected future cash flows, discounted based on the effective yield. The non-credit component represents the difference between the security's fair value and the present value of expected future cash flows.

The following table summarizes other-than-temporary impairment losses on debt securities recognized in earnings for the three and six months ended June 30, 2012 and 2011:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Total OTTI losses	\$ 21	\$ 27	\$ 25	\$ 50
Portion of other-than-temporary losses recorded in AOCI	(8)	(21)	2	(41)
Net OTTI losses recognized in earnings	\$ 13	\$ 6	\$ 27	\$ 9

As indicated in the table above, we recorded credit related losses in earnings totaling \$13 million and \$6 million for the three months ended June 30, 2012 and 2011, respectively and \$27 million and \$9 million for the six months ended June 30, 2012 and 2011. The cumulative non-credit related portion of OTTI on these securities recorded in AOCI totaled \$116 million as of both June 30, 2012 and 2011. We estimate the portion of loss attributable to credit using a discounted cash flow model, and we estimate the expected cash flows from the underlying collateral using industry-standard third party modeling tools. These tools take into consideration security specific delinquencies, product specific delinquency roll rates and expected severities. Key assumptions used in estimating the expected cash flows include default rates, loss severity and prepayment rates. Assumptions used can vary widely based on the collateral underlying the securities and are influenced by factors such as collateral type, loan interest rate, geographical location of the borrower, and borrower characteristics.

We believe the gross unrealized losses related to all other securities of \$97 million and \$57 million as of June 30, 2012 and December 31, 2011, respectively, are attributable to issuer specific credit spreads and changes in market interest rates and asset spreads. Therefore, we currently do not expect to incur credit losses related to these securities. In addition, we have no intent to sell these securities with unrealized losses and it is not more likely than not that we will be required to sell these securities prior to recovery of the amortized cost. Accordingly, we have concluded that the impairment on these securities is not other-than-temporary.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The table below presents activity for the three and six months ended June 30, 2012 and 2011, related to the credit component of OTTI recognized in earnings on investment debt securities:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Credit loss component, beginning of period	\$ 82	\$ 50	\$ 68	\$ 49
Additions:				
Initial credit impairment	9	2	10	3
Subsequent credit impairment	4	4	17	6
Total additions	13	6	27	9
Reductions:				
Sales of credit-impaired securities	0	0	0	(2)
Total reductions	0	0	0	(2)
Ending balance	\$ 95	\$ 56	\$ 95	\$ 56

**AOCI, Net of Taxes, Related to Securities Available for Sale**

The table below presents the changes in AOCI, net of taxes, related to our available-for-sale securities. The net unrealized gains (losses) represent the fair value adjustments recorded on available-for-sale securities, net of tax, during the period. The net reclassification adjustment for net realized losses (gains) represent the amount of those fair value adjustments, net of tax, that were recognized in earnings due to the sale of an available-for-sale security or the recognition of an other-than-temporary impairment loss.

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Beginning balance AOCI related to securities available for sale, net of tax <sup>(1)</sup>	\$ 310	\$ 311	\$ 286	\$ 369
Net unrealized gains (losses), net of tax <sup>(2)</sup>	126	164	157	109
Net realized losses (gains) reclassified from AOCI into earnings, net of tax <sup>(3)</sup>	(19)	3	(26)	0
Ending balance AOCI related to securities available for sale, net of tax	\$ 417	\$ 478	\$ 417	\$ 478

<sup>(1)</sup> Net of tax provision of \$178 million and \$171 million for the three months ended June 30, 2012 and 2011, respectively and \$157 million and \$203 million for the six months ended June 30, 2012 and 2011, respectively.

<sup>(2)</sup> Net of tax provision of \$69 million and \$90 million for the three months ended June 30, 2012 and 2011, respectively and \$88 million and \$60 million for the six months ended June 30, 2012 and 2011, respectively.

<sup>(3)</sup> Net of tax provision of \$11 million and \$2 million for the three months ended June 30, 2012 and 2011, respectively and net of tax provision of \$15 million and \$0 million for the six months ended June 30, 2012 and 2011, respectively.

**Realized Gains and Losses on Securities Available for Sale**

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

The following table presents the gross realized gains and losses on the sale and redemption of available-for-sale securities recognized in earnings for the three and six months ended June 30, 2012 and 2011. The gross realized investment losses presented below exclude credit losses recognized in earnings attributable to OTTI. We sold approximately \$6.9 billion and \$1.7 billion of investment securities for the three months ended June 30, 2012 and

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

2011, respectively and \$14.3 billion and \$2.6 billion for the six months ended June 30, 2012 and 2011, respectively. These sales resulted in net gains of \$30 million and \$8 million for the three months ended June 30, 2012 and 2011, respectively and \$41 million and \$11 million for the six months ended June 30, 2012 and 2011, respectively.

(Dollars in millions)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Gross realized investment gains	\$ 32	\$ 9	\$ 49	\$ 14
Gross realized investment losses	(2)	(1)	(8)	(3)
Net realized gains	\$ 30	\$ 8	\$ 41	\$ 11
Total proceeds from sales	\$ 6,921	\$ 1,724	\$ 14,258	\$ 2,570

**Securities Pledged**

As part of our liquidity management strategy, we pledge securities to secure borrowings from the Federal Home Loan Bank ( FHLB ) and the Federal Reserve Bank. We also pledge securities to secure trust and public deposits and for other purposes as required or permitted by law. We pledged securities with a fair value of \$7.6 billion and \$8.8 billion as of June 30, 2012 and December 31, 2011, respectively.

**Securities Acquired**

In connection with the acquisition of ING Direct on February 17, 2012, we acquired investment debt securities with a fair value of \$30.2 billion. We concluded that a portion of the investment debt securities we acquired from ING Direct had some evidence of credit deterioration for which it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments. These investment debt securities are considered credit-impaired investment debt securities. The ING Direct investment debt securities we concluded were credit-impaired had contractual outstanding unpaid principal and interest balance at acquisition of \$5.6 billion and estimated fair value of \$2.9 billion.

In determining the fair value of the credit-impaired investment debt securities at acquisition, we employed a methodology consistent with how we derive the fair value for our existing available-for-sale securities population. That is, we utilized third party pricing services to obtain fair value measures for these securities. The techniques used by these pricing services utilize observable market data to the extent available. Pricing models may be used, which can vary by asset class and may incorporate available trade, bid and other market information. Across asset classes, information such as trader/dealer input, credit spreads, forward curves, and prepayment speeds are used to help determine appropriate valuations. Because many fixed income securities do not trade on a daily basis, the evaluated pricing applications may apply available information through processes such as benchmarking curves, like securities, sector groupings, and matrix pricing to prepare valuations. In addition, model processes are used by the pricing services to develop prepayment and interest rate scenarios.

We validated the pricing obtained from the primary pricing providers through comparison of pricing to additional sources, including other pricing services, dealer pricing indications in transaction results, and other internal sources. Pricing variances among different pricing sources were analyzed and validated.

The difference between contractually required payments due and the cash flows we expect to collect at acquisition, considering the impact of prepayments, is referred to as the nonaccretable difference. The



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

nonaccretable difference, which is neither accreted into income nor recorded on our consolidated balance sheet, reflects estimated future credit losses expected to be incurred over the life of the security. The excess of cash flows expected to be collected over the estimated fair value of credit-impaired debt securities is referred to as the accretable yield. This amount is not recorded on our consolidated balance sheet, but is accreted into interest income over the remaining life of the security using the effective interest method.

Subsequent to acquisition, we complete quarterly evaluations of expected cash flows. Decreases in expected cash flows attributable to credit will result in an other-than-temporary impairment. Increases in expected cash flows are recognized prospectively over the remaining life of the security through adjustment to the accretable yield.

For acquired debt securities that are not deemed impaired at acquisition, subsequent to acquisition we recognize unamortized premiums and discounts in interest income over the contractual life of the security using the effective interest method.

***Initial Fair Value and Accretable Yield of Acquired Credit-Impaired Investment Debt Securities***

The table below displays the contractually required principal and interest cash flows expected to be collected and the fair value at acquisition related to the acquired ING Direct credit-impaired investment debt securities we acquired. The table also displays the nonaccretable difference and the accretable yield at acquisition.

**At Acquisition on February 17, 2012**

<b>(Dollars in millions)</b>	<b>Purchased Credit-Impaired Securities</b>
Contractually outstanding principal and interest at acquisition	<b>\$ 5,646</b>
Less: Nonaccretable difference (expected principal losses of \$1.1 billion and foregone interest of \$157 million)	<b>(1,260)</b>
Cash flows expected to be collected at acquisition <sup>(1)</sup>	<b>4,386</b>
Less: Accretable yield	<b>(1,474)</b>
Fair value of securities acquired	<b>\$ 2,912</b>

<sup>(1)</sup> Represents undiscounted expected principal and interest cash flows at acquisition.

***Outstanding Balance and Carrying Value of Acquired Securities***

The table below presents the outstanding contractual balance and the carrying value of the acquired credit-impaired investment debt securities as of June 30, 2012:

<b>(Dollars in millions)</b>	<b>June 30, 2012 Purchased Credit-Impaired Securities</b>
Contractual balance	<b>\$ 5,212</b>

Carrying value

\$ 2,645



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)*****Changes in Accretable Yield of Acquired Securities***

The following table presents changes in the accretable yield related to the acquired credit-impaired investment debt securities:

<b>(Dollars in millions)</b>	<b>Purchased Credit-Impaired Securities</b>
Accretable yield prior to February 17, 2012	\$ 0
Additions from new acquisitions	1,474
Accretion recognized in earnings	(12)
Reductions due to disposals, transfers, and other non-credit related changes	0
Net reclassifications (to)/from nonaccretable difference	0
Accretable yield as of March 31, 2012	\$ 1,462
Additions from new acquisitions	4
Accretion recognized in earnings	(22)
Reductions due to disposals, transfers, and other non-credit related changes	0
Net reclassifications (to)/from nonaccretable difference	132
Accretable yield as of June 30, 2012	\$ 1,576

**NOTE 5 LOANS****Loan Portfolio Composition**

Our total loan portfolio consists of loans we own and loans underlying our securitization trusts. The table below presents the composition of our held-for investment loan portfolio, including restricted loans for securitization investors, as of June 30, 2012 and December 31, 2011. Our loan portfolio consists of credit card, consumer banking and commercial banking loans. Credit card loans consist of domestic and international credit card loans as well as installment loans. Consumer banking loans consist of auto, home, and retail banking loans. Commercial banking loans consist of commercial and multifamily real estate, commercial and industrial and small-ticket commercial real estate loans.

***Acquired Loans***

Our portfolio of acquired loans consists of loans acquired in the HSBC U.S. card, ING Direct, and Chevy Chase Bank acquisition. These loans were recorded at fair value as of the date of acquisition.

***Acquired Loans Accounted for Based on Expected Cash Flows***

We use the term "acquired loans" to refer to a limited portion of the credit card loans acquired in the HSBC U.S. card acquisition and the substantial majority of consumer and commercial loans acquired in the ING Direct and CCB acquisitions, which are accounted for based on

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

expected cash flows to be collected. Acquired loans accounted for based on expected cash flows to be collected increased to \$41.7 billion as of June 30, 2012, from \$4.7 billion as of December 31, 2011. The increase was largely due to the ING Direct acquisition.

We regularly update our estimate of the amount of expected principal and interest to be collected from these loans and evaluate the results on an aggregated pool basis for loans with common risk characteristics. Probable decreases in expected loan principal cash flows would trigger the recognition of impairment through our

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

provision for credit losses. Probable and significant increases in expected cash flows would first reverse any previously recorded allowance for loan and lease losses, with any remaining increase in expected cash flows recognized prospectively in interest income over the remaining estimated life of the underlying loans. We decreased the allowance and recorded a benefit through our provision for credit losses of \$2 million for the three months ended June 30, 2012 and increased the allowance and recorded a provision for credit losses of \$11 million for the six months ended June 30, 2012 related to certain pools of acquired loans. The cumulative impairment recognized on acquired loans totaled \$37 million and \$26 million as of June 30, 2012 and December 31, 2011, respectively. The credit performance of the remaining pools has generally been in line with our expectations, and, in some cases, more favorable than expected, which has resulted in the reclassification of amounts from the nonaccretable difference to the accretable yield.

*Acquired Loans Accounted for Based on Contractual Cash Flows*

Of the loans acquired in the HSBC U.S. card acquisition, there were loans of \$26.2 billion designated as held for investment that had existing revolving privileges at acquisition and were therefore excluded from the accounting guidance applied to the acquired loans described in the paragraphs above.

These loans were recorded at a fair value of \$26.9 billion, resulting in a net premium of \$705 million at acquisition. Fair value was determined by discounting all expected cash flows (contractual principal, interest, finance charges and fees of \$33.3 billion less those amounts not expected to be collected of \$3.0 billion) at a market discount rate.

Under applicable accounting guidance, we are required to amortize the net premium of \$705 million over the contractual principal amount as an adjustment to interest income over the remaining life of the loans. Given the guidance applicable to acquired revolving loans, it is necessary to record an allowance through provision expense to properly recognize an estimate of incurred losses on the existing principal balances, which represents a portion of the total amounts not expected to be collected described above. In the second quarter of 2012, we recorded provision expense of \$1.2 billion to establish an allowance primarily related to these loans. The allowance was calculated using the same methodology utilized for determining the allowance for our existing credit card portfolio. The provision expense of \$1.2 billion is included in the total provision for credit losses of \$1.7 billion recorded in the second quarter of 2012 as indicated in Note 6 Allowance for Loan and Lease Losses.

Excluded from the amounts above are acquired HSBC U.S. card revolving loans with a fair value of \$471 million that we designated as held for sale at acquisition. We expect to close the sale of these receivables early in the third quarter.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	June 30, 2012	December 31, 2011
<b>Credit card business:</b>		
Domestic credit card loans	\$ 79,530	\$ 54,682
International credit card loans	8,116	8,466
Total credit card loans	87,646	63,148
Domestic installment loans	1,268	1,927
Total installment loans	1,268	1,927
Total credit card	88,914	65,075
<b>Consumer Banking business:</b>		
Auto	25,251	21,779
Home loan	48,224	10,433
Other retail	4,140	4,103
Total consumer banking	77,615	36,315
<b>Commercial Banking business:<sup>(1)</sup></b>		
Commercial and multifamily real estate	16,254	15,736
Commercial and industrial	18,467	17,088
Total commercial lending	34,721	32,824
Small-ticket commercial real estate	1,335	1,503
Total commercial banking	36,056	34,327
<b>Other:</b>		
Other loans	164	175
Total loans	\$ 202,749	\$ 135,892

<sup>(1)</sup> Includes construction loans and land development loans totaling \$2.3 billion and \$2.2 billion as of June 30, 2012 and December 31, 2011, respectively.

The significant increase in loans held for investment from was attributable to the addition of \$40.4 billion of loans from the ING Direct acquisition and \$27.8 billion of unpaid principal balance and accrued interest receivable of loans classified as held for investment from the HSBC U.S. card acquisition, which was partially offset by the continued expected run-off of loans in businesses we exited or repositioned, other loan pay downs and charge-offs.

**Credit Quality**

We closely monitor economic conditions and loan performance trends to manage and evaluate our exposure to credit risk. Trends in delinquency ratios are an indicator, among other considerations, of credit risk within our loan portfolios. The level of nonperforming assets represents another indicator of the potential for future credit losses. Accordingly, key metrics we track and use in evaluating the credit quality of our loan portfolio include delinquency and nonperforming asset rates, as well as charge-off rates and our internal risk ratings of larger balance, commercial loans.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table summarizes the payment status of loans in our total loan portfolio, including an aging of delinquent loans, loans 90 days or more past due continuing to accrue interest and loans classified as nonperforming. We present information below on the credit performance of our loan portfolio, by major loan category, including key metrics that we use in tracking changes in the credit quality of each of our loan portfolios. The delinquency aging includes all past due loans, both performing and nonperforming, as of June 30, 2012 and December 31, 2011.

Loans 90 days or more past due totaled approximately \$1.8 billion and \$2.0 billion as of June 30, 2012 and December 31, 2011, respectively. Loans classified as nonperforming totaled \$1.0 billion and \$1.1 billion as of June 30, 2012 and December 31, 2011, respectively.

(Dollars in millions)	June 30, 2012								
	Current	30-59 Days	60-89 Days	<sup>3</sup> 90 Days	Total Delinquent Loans	Acquired Loans <sup>(1)</sup>	Total Loans	<sup>3</sup> 90 Days and Accruing <sup>(2)</sup>	Nonperforming Loans <sup>(2)</sup>
<b>Credit card:</b>									
Domestic credit card	\$ 78,017	\$ 835	\$ 536	\$ 881	\$ 2,252	\$ 529	\$ 80,798	\$ 881	\$ 0
International credit card	7,724	132	85	175	392	0	8,116	175	0
Total credit card	85,741	967	621	1,056	2,644	529	88,914	1,056	0
<b>Consumer Banking:</b>									
Auto	23,820	942	370	89	1,401	30	25,251	0	89
Home loan	7,154	69	32	327	428	40,642	48,224	0	439
Retail banking	4,012	27	8	52	87	41	4,140	2	86
Total consumer banking	34,986	1,038	410	468	1,916	40,713	77,615	2	614
<b>Commercial Banking:</b>									
Commercial and multifamily real estate	15,877	24	14	149	187	190	16,254	14	200
Commercial and industrial	18,146	20	3	57	80	241	18,467	2	140
Total commercial lending	34,023	44	17	206	267	431	34,721	16	340
Small-ticket commercial real estate	1,284	41	5	5	51	0	1,335	0	16
Total commercial banking	35,307	85	22	211	318	431	36,056	16	356
<b>Other:</b>									
Other loans	113	12	7	32	51	0	164	0	40
Total	\$ 156,147	\$ 2,102	\$ 1,060	\$ 1,767	\$ 4,929	\$ 41,673	\$ 202,749	\$ 1,074	\$ 1,010
% of Total loans	77.0%	1.0%	0.5%	0.9%	2.4%	20.6%	100.0%	0.5%	0.5%

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	December 31, 2011								
	Current	30-59 Days	60-89 Days	<sup>3</sup> 90 Days	Total Delinquent Loans	Acquired Loans <sup>(1)</sup>	Total Loans	<sup>3</sup> 90 Days and Accruing <sup>(2)</sup>	Nonperforming Loans <sup>(2)</sup>
<b>Credit card:</b>									
Domestic credit card	\$ 54,536	\$ 627	\$ 445	\$ 1,001	\$ 2,073	\$ 0	\$ 56,609	\$ 1,001	\$ 0
International credit card	8,028	145	98	195	438	0	8,466	195	0
Total credit card	62,564	772	543	1,196	2,511	0	65,075	1,196	0
<b>Consumer Banking:</b>									
Auto	20,128	1,075	423	106	1,604	47	21,779	0	106
Home loan	5,843	89	43	346	478	4,112	10,433	1	456
Retail banking	3,964	24	17	53	94	45	4,103	4	90
Total consumer banking	29,935	1,188	483	505	2,176	4,204	36,315	5	652
<b>Commercial Banking:</b>									
Commercial and multifamily real estate	15,231	172	23	147	342	163	15,736	34	207
Commercial and industrial	16,618	63	16	73	152	318	17,088	7	125
Total commercial lending	31,849	235	39	220	494	481	32,824	41	332
Small-ticket commercial real estate	1,362	98	19	24	141	0	1,503	0	40
Total commercial banking	33,211	333	58	244	635	481	34,327	41	372
<b>Other:</b>									
Other loans	129	13	8	25	46	0	175	0	35
Total	\$ 125,839	\$ 2,306	\$ 1,092	\$ 1,970	\$ 5,368	\$ 4,685	\$ 135,892	\$ 1,242	\$ 1,059
% of Total loans	92.6%	1.7%	0.8%	1.5%	4.0%	3.4%	100.00%	0.9%	0.8%

<sup>(1)</sup> Acquired loans include loans acquired and accounted for under the accounting guidance for loans acquired in a transfer including business combinations. These loans are subsequently accounted for based on the acquired loan's expected cash flows. Excludes loans subsequently accounted for based on the acquired loan's contractual cash flows.

<sup>(2)</sup> Acquired loans are excluded from loans reported as 90 days and still accruing interest and nonperforming loans.

**Credit Card**

Our credit card loan portfolio is generally highly diversified across millions of accounts and multiple geographies without significant individual exposures. We therefore generally manage credit risk on a portfolio basis. The risk in our credit card portfolio is correlated with broad economic trends, such as unemployment rates, gross domestic product (GDP) growth, and home values, as well as customer liquidity, which can have a material effect on credit performance. The primary factors we assess in monitoring the credit quality and risk of our credit card portfolio are delinquency and charge-off trends, including an analysis of the migration of loans between delinquency categories over time. The table below displays the geographic profile of our credit card loan portfolio and delinquency statistics as of June 30, 2012 and December 31, 2011. We also present comparative net-charge offs for the second quarter and first six months of 2012 and 2011.





**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Credit Card: Risk Profile by Geographic Region and Delinquency Status**

(Dollars in millions)			June 30, 2012				December 31, 2011			
	Loans	% of Total <sup>(1)</sup>	Acquired Loans	% of Total <sup>(1)</sup>	Total	% of Total <sup>(1)</sup>	Total	% of Total <sup>(1)</sup>		
<b>Domestic credit card and installment loans:</b>										
California	\$ 8,982	10.1%	\$ 58	0.1%	\$ 9,040	10.2%	\$ 6,410	9.9%		
Texas	5,713	6.4	43	0.1	5,756	6.5	3,862	5.9		
New York	5,642	6.4	40	0.1	5,682	6.5	3,737	5.7		
Florida	4,645	5.2	31	0.0	4,676	5.2	3,382	5.2		
Illinois	3,950	4.4	27	0.0	3,977	4.4	2,664	4.1		
Pennsylvania	3,704	4.2	25	0.0	3,729	4.2	2,575	4.0		
Ohio	3,242	3.7	22	0.0	3,264	3.7	2,284	3.5		
New Jersey	2,941	3.3	18	0.0	2,959	3.3	2,162	3.3		
Michigan	2,830	3.2	21	0.0	2,851	3.2	1,834	2.8		
Other	38,620	43.4	244	0.3	38,864	43.7	27,699	42.6		
Total domestic credit card and installment loans	80,269	90.3	529	0.6	80,798	90.9	56,609	87.0		
<b>International credit card:</b>										
United Kingdom	3,585	4.0	0	0.0	3,585	4.0	3,828	5.9		
Canada	4,531	5.1	0	0.0	4,531	5.1	4,638	7.1		
Total international credit card	8,116	9.1	0	0.0	8,116	9.1	8,466	13.0		
Total Credit Card	\$ 88,385	99.4%	\$ 529	0.6%	\$ 88,914	100.0%	\$ 65,075	100.0%		
<b>Selected credit metrics:</b>										
30+ day delinquencies <sup>(2)</sup>	\$ 2,235	2.51%	\$ 409	0.46%	\$ 2,644	2.97%	\$ 2,511	3.86%		
90+ day delinquencies <sup>(2)</sup>	693	0.78	363	0.41	1,056	1.19	1,196	1.84		
<b>Net charge-offs:</b>										
			Three Months Ended June 30,				Six Months Ended June 30,			
			2012		2011		2012		2011	
(Dollars in millions)	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate		
Domestic credit card	\$ 510	2.86%	\$ 638	4.74%	\$ 1,041	3.32%	\$ 1,442	5.45%		
International credit card	112	5.49	155	7.02	227	5.51	280	6.39		
Total <sup>(3)</sup>	\$ 622	3.13%	\$ 793	5.06%	\$ 1,268	3.57%	\$ 1,722	5.59%		

(1)

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Percentages by geographic region within the domestic and international credit card portfolios are calculated based on the total held-for-investment credit card loans as of the end of the reported period.

- (2) Delinquency rates calculated by dividing delinquent credit card loans by the total balance of credit card loans held for investment as of the end of the reported period.
- (3) Calculated by dividing net charge-offs by average credit card loans held for investment during the three and six months ended June 30, 2012 and 2011.

The 30+ day delinquency rate for our entire credit card loan portfolio, decreased to 2.97% as of June 30, 2012, from 3.86% as of December 31, 2011, reflecting strong underlying credit improvement trends.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Consumer Banking**

Our consumer banking loan portfolio consists of auto, home loan and retail banking loans. Similar to our credit card loan portfolio, the risk in our consumer banking loan portfolio is correlated with broad economic trends, such as unemployment rates, gross domestic product ( GDP ) growth, and home values, as well as customer liquidity, which can have a material effect on credit performance. Delinquency, nonperforming loans and charge-off trends are key factors we assess in monitoring the credit quality and risk of our consumer banking loan portfolio. The table below displays the geographic profile of our consumer banking loan portfolio, including acquired loans. We also present the delinquency and nonperforming loan rates of our consumer banking loan portfolio, excluding acquired loans, as of June 30, 2012 and December 31, 2011, and net-charge offs for the three and six months ended June 30, 2012 and 2011.

**Consumer Banking: Risk Profile by Geographic Region, Delinquency Status and Performing Status**

(Dollars in millions)	Loans		June 30, 2012 Acquired Loans		Total	
	Loans	% of Total <sup>(1)</sup>	Loans	% of Total <sup>(1)</sup>	Loans	% of Total <sup>(1)</sup>
<b>Auto:</b>						
Texas	\$ 4,211	5.4%	\$ 0	0.0%	\$ 4,211	5.4%
California	2,377	3.1	0	0.0	2,377	3.1
Louisiana	1,471	1.9	0	0.0	1,471	1.9
Florida	1,467	1.9	0	0.0	1,467	1.9
Georgia	1,301	1.7	0	0.0	1,301	1.7
Illinois	1,070	1.4	0	0.0	1,070	1.4
New York	1,013	1.3	0	0.0	1,013	1.3
Other	12,311	15.8	30	0.1	12,341	15.9
Total auto	\$ 25,221	32.5%	\$ 30	0.1%	\$ 25,251	32.6%
<b>Home loan:</b>						
California	\$ 1,126	1.5%	\$ 10,086	13.0%	\$ 11,212	14.5%
New York	1,760	2.3	1,792	2.3	3,552	4.6
Illinois	92	0.1	3,291	4.2	3,383	4.3
Maryland	376	0.5	2,064	2.7	2,440	3.2
New Jersey	405	0.5	1,887	2.4	2,292	2.9
Virginia	304	0.4	1,930	2.5	2,234	2.9
Florida	179	0.2	2,041	2.6	2,220	2.8
Other	3,340	4.3	17,551	22.6	20,891	26.9
Total home loan	\$ 7,582	9.8%	\$ 40,642	52.3%	\$ 48,224	62.1%
<b>Retail banking:</b>						
Louisiana	\$ 1,583	2.0%	\$ 0	0.0%	\$ 1,583	2.0%
Texas	903	1.2	0	0.0	903	1.2
New York	882	1.1	0	0.0	882	1.1
New Jersey	326	0.4	0	0.0	326	0.4
Maryland	124	0.1	22	0.1	146	0.2
Virginia	84	0.1	12	0.0	96	0.1
District of Columbia	27	0.1	5	0.0	32	0.1

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Other	<b>170</b>	<b>0.2</b>	<b>2</b>	<b>0.0</b>	<b>172</b>	<b>0.2</b>
Total retail banking	<b>\$ 4,099</b>	<b>5.2%</b>	<b>\$ 41</b>	<b>0.1%</b>	<b>\$ 4,140</b>	<b>5.3%</b>
Total consumer banking	<b>\$ 36,902</b>	<b>47.5%</b>	<b>\$ 40,713</b>	<b>52.5%</b>	<b>\$ 77,615</b>	<b>100.0%</b>

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	June 30, 2012							
	Auto		Home Loan		Retail Banking		Total Consumer Banking	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
<b>Credit performance:<sup>(2)</sup></b>								
30+ day delinquencies	\$ 1,401	5.55%	\$ 428	0.89%	\$ 87	2.10%	\$ 1,916	2.47%
90+ day delinquencies	89	0.35%	327	0.68%	52	1.26%	468	0.60
Nonperforming loans	89	0.35%	439	0.91%	86	2.09%	614	0.79

(Dollars in millions)	December 31, 2011						
	Loans		Acquired Loans		Total		
	Loans	% of Total <sup>(1)</sup>	Loans	% of Total <sup>(1)</sup>	Loans	% of Total <sup>(1)</sup>	
<b>Auto:</b>							
Texas	\$ 3,901	10.7%	\$ 0	0.0%	\$ 3,901	10.7%	
California	1,837	5.1	0	0.0	1,837	5.1	
Louisiana	1,389	3.8	0	0.0	1,389	3.8	
Florida	1,196	3.3	0	0.0	1,196	3.3	
Georgia	1,124	3.1	0	0.0	1,124	3.1	
Illinois	950	2.6	0	0.0	950	2.6	
New York	940	2.6	0	0.0	940	2.6	
Other	10,395	28.7	47	0.1	10,442	28.8	
Total auto	\$ 21,732	59.9%	\$ 47	0.1%	\$ 21,779	60.0%	
<b>Home loan:</b>							
New York	\$ 1,770	4.9%	\$ 276	0.8%	\$ 2,046	5.7%	
California	768	2.1	1,128	3.1	1,896	5.2	
Louisiana	1,528	4.2	2	0.0	1,530	4.2	
Maryland	286	0.8	618	1.7	904	2.5	
Virginia	206	0.6	588	1.6	794	2.2	
New Jersey	344	0.9	235	0.6	579	1.5	
Other	1,419	3.9	1,265	3.5	2,684	7.4	
Total home loan	\$ 6,321	17.4%	\$ 4,112	11.3%	\$ 10,433	28.7%	
<b>Retail banking:</b>							
Louisiana	\$ 1,514	4.2%	\$ 0	0.0%	\$ 1,514	4.2%	
Texas	930	2.6	0	0.0	930	2.6	
New York	896	2.5	0	0.0	896	2.5	
New Jersey	295	0.8	0	0.0	295	0.8	
District of Columbia	254	0.7	7	0.0	261	0.7	
Maryland	49	0.1	23	0.1	72	0.2	
Virginia	30	0.1	12	0.0	42	0.1	
Other	90	0.2	3	0.0	93	0.2	
Total retail banking	\$ 4,058	11.2%	\$ 45	0.1%	\$ 4,103	11.3%	
Total consumer banking	\$ 32,111	88.5%	\$ 4,204	11.5%	\$ 36,315	100.0%	



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	December 31, 2011							
	Auto		Home Loan		Retail Banking		Total Consumer Banking	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
<b>Credit performance:<sup>(2)</sup></b>								
30+ day delinquencies	\$ 1,604	7.36%	\$ 478	4.58%	\$ 94	2.29%	\$ 2,176	5.99%
90+ day delinquencies	106	0.48	346	3.32	53	1.29	505	1.39
Nonperforming loans	106	0.48	456	4.37	90	2.18	652	1.79

(Dollars in millions)	Three Months Ended June 30, 2012							
	Auto		Home Loan		Retail Banking		Total Consumer Banking	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
Net charge-offs <sup>(3)</sup>	\$ 68	1.11%	\$ 12	0.09%	\$ 13	1.27%	\$ 93	0.48%

(Dollars in millions)	Three Months Ended June 30, 2011							
	Auto		Home Loan		Retail Banking		Total Consumer Banking	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
Net charge-offs <sup>(3)</sup>	\$ 52	1.11%	\$ 17	0.60%	\$ 19	1.73%	\$ 88	1.01%

(Dollars in millions)	Six Months Ended June 30, 2012							
	Auto		Home Loan		Retail Banking		Total Consumer Banking	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
Net charge-offs <sup>(3)</sup>	\$ 147	1.25%	\$ 27	0.13%	\$ 27	1.33%	\$ 201	0.60%

(Dollars in millions)	Six Months Ended June 30, 2011							
	Auto		Home Loan		Retail Banking		Total Consumer Banking	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
Net charge-offs <sup>(3)</sup>	\$ 141	1.53%	\$ 38	0.65%	\$ 42	2.00%	\$ 221	1.29%

(1) Percentages by geographic region are calculated based on the total held-for-investment consumer banking loans as of the end of the reported period.

(2) Credit performance statistics exclude acquired loans, which were recorded at fair value at acquisition. Although acquired loans may be contractually delinquent, we separately track these loans and do not include them in our delinquency and nonperforming loan statistics as the fair value recorded at acquisition included an estimate of credit losses expected to be realized over the remaining lives of the loans.

(3) Calculated by dividing net charge-offs by average loans held for investment for the three and six months ended June 30, 2012 and 2011.

**Home Loan**

Our home loan portfolio consists of both first-lien and second-lien residential mortgage loans. In evaluating the credit quality and risk of our home loan portfolio, we continually monitor a variety of mortgage loan characteristics that may affect the default experience on our overall

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

home loan portfolio, such as vintage, geographic concentrations, lien priority and product type. Certain loan concentrations have experienced higher delinquency rates as a result of the significant decline in home prices since the home price peak in 2006 and rise in unemployment. These loan concentrations include loans originated during 2008, 2007 and 2006 in an environment of decreasing home sales, broadly declining home prices and more relaxed underwriting standards



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

and loans on properties in Arizona, California, Florida and Nevada, which have experienced the most severe decline in home prices. The following table presents the distribution of our home loan portfolio as of June 30, 2012 and December 31, 2011, based on selected key risk characteristics.

**Home Loan: Risk Profile by Vintage, Geography, Lien Priority and Interest Rate Type**

(Dollars in millions)	Loans		June 30, 2012 Acquired Loans		Total Home Loans	
	Amount	% of Total <sup>(1)</sup>	Amount	% of Total <sup>(1)</sup>	Amount	% of Total <sup>(1)</sup>
<b>Origination year:</b>						
< = 2005	\$ 3,844	8.0%	\$ 5,251	10.9%	\$ 9,095	18.9%
2006	683	1.4	3,079	6.4	3,762	7.8
2007	493	1.0	6,674	13.8	7,167	14.8
2008	290	0.6	5,764	12.0	6,054	12.6
2009	192	0.4	3,974	8.2	4,166	8.6
2010	218	0.5	7,019	14.6	7,237	15.1
2011	355	0.7	7,814	16.2	8,169	16.9
2012	1,507	3.1	1,067	2.2	2,574	5.3
<b>Total</b>	<b>\$ 7,582</b>	<b>15.7%</b>	<b>\$ 40,642</b>	<b>84.3%</b>	<b>\$ 48,224</b>	<b>100.0%</b>
<b>Geographic concentration:<sup>(2)</sup></b>						
California	\$ 1,126	2.3%	\$ 10,086	20.9%	\$ 11,212	23.2%
New York	1,760	3.7	1,792	3.7	3,552	7.4
Illinois	92	0.2	3,291	6.8	3,383	7.0
Maryland	376	0.8	2,064	4.3	2,440	5.1
New Jersey	405	0.8	1,887	3.9	2,292	4.7
Virginia	304	0.6	1,930	4.0	2,234	4.6
Florida	179	0.4	2,041	4.2	2,220	4.6
Arizona	90	0.2	2,043	4.3	2,133	4.5
Washington	110	0.2	1,991	4.1	2,101	4.3
Colorado	121	0.3	1,795	3.8	1,916	4.1
Other	3,019	6.2	11,722	24.3	14,741	30.5
<b>Total</b>	<b>\$ 7,582</b>	<b>15.7%</b>	<b>\$ 40,642</b>	<b>84.3%</b>	<b>\$ 48,224</b>	<b>100.0%</b>
<b>Lien type:</b>						
1 <sup>st</sup> lien	\$ 6,313	13.1%	\$ 40,096	83.2%	\$ 46,409	96.3%
2 <sup>nd</sup> lien	1,269	2.6	546	1.1	1,815	3.7
<b>Total</b>	<b>\$ 7,582</b>	<b>15.7%</b>	<b>\$ 40,642</b>	<b>84.3%</b>	<b>\$ 48,224</b>	<b>100.0%</b>
<b>Interest rate type:</b>						
Fixed rate	\$ 2,568	5.3%	\$ 4,486	9.3%	\$ 7,054	14.6%
Adjustable rate	5,014	10.4	36,156	75.0	41,170	85.4
<b>Total</b>	<b>\$ 7,582</b>	<b>15.7%</b>	<b>\$ 40,642</b>	<b>84.3%</b>	<b>\$ 48,224</b>	<b>100.0%</b>



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	Loans		December 31, 2011 Acquired Loans		Total Home Loans	
	Amount	% of Total <sup>(1)</sup>	Amount	% of Total <sup>(1)</sup>	Amount	% of Total <sup>(1)</sup>
<b>Origination year:</b>						
< = 2005	\$ 4,113	39.4%	\$ 1,675	16.1%	\$ 5,788	55.5%
2006	699	6.7	908	8.7	1,607	15.4
2007	508	4.9	1,114	10.7	1,622	15.6
2008	243	2.3	325	3.1	568	5.4
2009	178	1.7	27	0.3	205	2.0
2010	237	2.3	49	0.4	286	2.7
2011	343	3.3	14	0.1	357	3.4
<b>Total</b>	<b>\$ 6,321</b>	<b>60.6%</b>	<b>\$ 4,112</b>	<b>39.4%</b>	<b>\$ 10,433</b>	<b>100.0%</b>
<b>Geographic concentration:<sup>(2)</sup></b>						
New York	\$ 1,770	17.0%	\$ 276	2.6%	\$ 2,046	19.6%
California	768	7.4	1,128	10.8	1,896	18.2
Louisiana	1,528	14.6	2	0.1	1,530	14.7
Maryland	286	2.7	618	5.9	904	8.6
Virginia	206	2.0	588	5.6	794	7.6
New Jersey	344	3.3	235	2.3	579	5.6
Texas	460	4.4	32	0.3	492	4.7
Florida	107	1.0	212	2.0	319	3.0
District of Columbia	69	0.7	158	1.5	227	2.2
Connecticut	87	0.8	76	0.7	163	1.5
Other	696	6.7	787	7.6	1,483	14.3
<b>Total</b>	<b>\$ 6,321</b>	<b>60.6%</b>	<b>\$ 4,112</b>	<b>39.4%</b>	<b>\$ 10,433</b>	<b>100.0%</b>
<b>Lien type:</b>						
1 <sup>st</sup> lien	\$ 5,194	49.8%	\$ 3,547	34.0%	\$ 8,741	83.8%
2 <sup>nd</sup> lien	1,127	10.8	565	5.4	1,692	16.2
<b>Total</b>	<b>\$ 6,321</b>	<b>60.6%</b>	<b>\$ 4,112</b>	<b>39.4%</b>	<b>\$ 10,433</b>	<b>100.0%</b>
<b>Interest rate type:</b>						
Fixed rate	\$ 2,627	25.2%	\$ 119	1.1%	\$ 2,746	26.3%
Adjustable rate	3,694	35.4	3,993	38.3	7,687	73.7
<b>Total</b>	<b>\$ 6,321</b>	<b>60.6%</b>	<b>\$ 4,112</b>	<b>39.4%</b>	<b>\$ 10,433</b>	<b>100.0%</b>

<sup>(1)</sup> Percentages within each risk category calculated based on total held-for-investment home loans.

<sup>(2)</sup> Represents the top ten states in which we have the highest concentration of home loans.

**Commercial Banking**

We evaluate the credit risk of commercial loans individually and use a risk-rating system to determine the credit quality of our commercial loans. We assign internal risk grades to loans based on relevant information about the ability of borrowers to service their debt. In determining

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

the risk rating of a particular loan, among the factors considered are the borrower's current financial condition, historical credit performance, projected future credit performance, prospects for support from financially responsible guarantors, the estimated realizable value of any collateral and current economic trends. The ratings scale based on our internal risk-rating system is as follows:

*Noncriticized:* Loans that have not been designated as criticized, frequently referred to as pass loans.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

*Criticized performing:* Loans in which the financial condition of the obligor is stressed, affecting earnings, cash flows or collateral values. The borrower currently has adequate capacity to meet near-term obligations; however, the stress, left unabated, may result in deterioration of the repayment prospects at some future date.

*Criticized nonperforming:* Loans that are not adequately protected by the current sound worth and paying capacity of the obligor or the collateral pledged, if any. Loans classified as criticized nonperforming have a well-defined weakness, or weaknesses, which jeopardize the repayment of the debt. These loans are characterized by the distinct possibility that we will sustain a credit loss if the deficiencies are not corrected.

We use our internal risk-rating system for regulatory reporting, determining the frequency of review of the credit exposures and evaluation and determination of the allowance for commercial loans. Loans of \$1 million or more designated as criticized performing and criticized nonperforming are reviewed quarterly by management for further deterioration or improvement to determine if they are appropriately classified/graded and whether impairment exists. All other loans greater than \$1 million are specifically reviewed at least annually to determine the appropriate loan grading. In addition, during the renewal process of any loan, as well if a loan becomes past due, we evaluate the risk rating.

The following table presents the geographic distribution and internal risk ratings of our commercial loan portfolio as of June 30, 2012 and December 31, 2011.

**Commercial Banking: Risk Profile by Geographic Region and Internal Risk Rating<sup>(1)</sup>**

(Dollars in millions)	June 30, 2012							
	Commercial & Multifamily		Commercial and Industrial		Small-ticket Commercial		Total Commercial	% of Total <sup>(2)</sup>
	Real Estate	% of Total <sup>(2)</sup>	Real Estate	% of Total <sup>(2)</sup>	Real Estate	% of Total <sup>(2)</sup>		
<b>Geographic concentration:<sup>(3)</sup></b>								
Loans:								
Northeast	\$ 12,828	78.9%	\$ 5,103	27.7%	\$ 807	60.4%	\$ 18,738	52.0%
Mid-Atlantic	1,061	6.5	1,037	5.6	50	3.8	2,148	6.0
South	1,719	10.6	8,296	44.9	84	6.3	10,099	28.0
Other	456	2.8	3,790	20.5	394	29.5	4,640	12.8
Loans	16,064	98.8	18,226	98.7	1,335	100.0	35,625	98.8
Acquired loans	190	1.2	241	1.3	0	0.0	431	1.2
<b>Total</b>	<b>\$ 16,254</b>	<b>100.0%</b>	<b>\$ 18,467</b>	<b>100.0%</b>	<b>\$ 1,335</b>	<b>100.0%</b>	<b>\$ 36,056</b>	<b>100.0%</b>
<b>Internal risk rating:<sup>(4)</sup></b>								
Loans:								
Noncriticized	\$ 14,896	91.6%	\$ 17,568	95.1%	\$ 1,281	96.0%	\$ 33,745	93.6%
Criticized performing	968	6.0	518	2.8	38	2.8	1,524	4.2
Criticized nonperforming	200	1.2	140	0.8	16	1.2	356	1.0
Loans	16,064	98.8	18,226	98.7	1,335	100.0	35,625	98.8
<b>Acquired loans:</b>								
Noncriticized	\$ 126	0.8%	\$ 222	1.2%	\$ 0	0.0%	\$ 348	1.0%
Criticized performing	64	0.4	19	0.1	0	0.0	83	0.2

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Total acquired loans	<b>190</b>	<b>1.2</b>	<b>241</b>	<b>1.3</b>	<b>0</b>	<b>0.0</b>	<b>431</b>	<b>1.2</b>
Total	<b>\$ 16,254</b>	<b>100.0%</b>	<b>\$ 18,467</b>	<b>100.0%</b>	<b>\$ 1,335</b>	<b>100.0%</b>	<b>\$ 36,056</b>	<b>100.0%</b>

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	December 31, 2011							
	Commercial & Multifamily Real Estate	% of Total <sup>(2)</sup>	Commercial and Industrial	% of Total <sup>(2)</sup>	Small-ticket Commercial Real Estate	% of Total <sup>(2)</sup>	Total Commercial	% of Total <sup>(2)</sup>
<b>Geographic concentration:<sup>(3)</sup></b>								
Loans:								
Northeast	\$ 11,470	72.9%	\$ 4,987	29.1%	\$ 790	52.6%	\$ 17,247	50.2%
Mid-Atlantic	1,305	8.3	763	4.5	56	3.7	2,124	6.2
South	1,743	11.1	8,324	48.7	93	6.2	10,160	29.6
Other	1,055	6.7	2,696	15.8	564	37.5	4,315	12.6
Loans	15,573	99.0	16,770	98.1	1,503	100.0	33,846	98.6
Acquired loans	163	1.0	318	1.9	0	0.0	481	1.4
Total	\$ 15,736	100.0%	\$ 17,088	100.0%	\$ 1,503	100.0%	\$ 34,327	100.0%
<b>Internal risk rating:<sup>(4)</sup></b>								
Loans:								
Noncriticized	\$ 14,256	90.6%	\$ 16,002	93.6%	\$ 1,359	90.4%	\$ 31,617	92.1%
Criticized performing	1,110	7.1	642	3.8	105	7.0	1,857	5.4
Criticized nonperforming	207	1.3	126	0.7	39	2.6	372	1.1
Loans	15,573	99.0	16,770	98.1	1,503	100.0	33,846	98.6
<b>Acquired loans:</b>								
Noncriticized	\$ 127	0.8%	\$ 303	1.8%	\$ 0	0.0%	\$ 430	1.3%
Criticized performing	36	0.2	15	0.1	0	0.0	51	0.1
Total acquired loans	163	1.0	318	1.9	0	0.0	481	1.4
Total	\$ 15,736	100.0%	\$ 17,088	100.0%	\$ 1,503	100.0%	\$ 34,327	100.0%

(1) Amounts based on total loans as of June 30, 2012 and December 31, 2011.

(2) Percentages calculated based on total held-for-investment commercial loans in each respective loan category as of the end of the reported period.

(3) Northeast consists of CT, ME, MA, NH, NJ, NY, PA and VT. Mid-Atlantic consists of DE, DC, MD, VA and WV. South consists of AL, AR, FL, GA, KY, LA, MS, MO, NC, SC, TN and TX.

(4) Criticized exposures correspond to the Special Mention, Substandard and Doubtful asset categories defined by banking regulatory authorities.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table presents information about our individually impaired loans, excluding acquired loans, which are reported separately and discussed below:

(Dollars in millions)	June 30, 2012							
	With an Allowance	Without an Allowance	Total Recorded Investment	Related Allowance	Net Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Income Recognized
<b>Credit card and Installment loans:</b>								
Domestic credit card and installment loan	\$ 668	\$ 0	\$ 668	\$ 210	\$ 458	\$ 652	\$ 680	\$ 34
International credit card and installment loans	191	0	191	120	71	181	192	6
Total credit card and installment loans <sup>(1)</sup>	859	0	859	330	529	833	872	40
<b>Consumer banking:</b>								
Auto	75	0	75	10	65	75	68	6
Home loan	106	0	106	17	89	117	104	1
Retail banking	58	29	87	8	79	91	87	1
Total consumer banking	239	29	268	35	233	283	259	8
<b>Commercial banking:</b>								
Commercial and multifamily real estate	170	188	358	35	323	405	358	2
Commercial and industrial	138	105	243	29	214	275	206	1
Total commercial lending	308	293	601	64	537	680	564	3
Small-ticket commercial real estate	6	15	21	1	20	29	20	0
Total commercial banking	314	308	622	65	557	709	584	3
Total	\$ 1,412	\$ 337	\$ 1,749	\$ 430	\$ 1,319	\$ 1,825	\$ 1,715	\$ 51



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	December 31, 2011							
	With an Allowance	Without an Allowance	Total Recorded Investment	Related Allowance	Net Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Income Recognized
<b>Credit card and Installment loans:</b>								
Domestic credit card and installment loan	\$ 708	\$ 0	\$ 708	\$ 244	\$ 464	\$ 691	\$ 736	\$ 73
International credit card and installment loans	190	0	190	109	81	179	181	7
Total credit card and installment loans <sup>(1)</sup>	898	0	898	353	545	870	917	80
<b>Consumer banking:</b>								
Auto	58	0	58	8	50	58	25	5
Home loan	104	0	104	10	94	110	79	5
Retail banking	65	26	91	12	79	97	55	1
Total consumer banking	227	26	253	30	223	265	159	11
<b>Commercial banking:</b>								
Commercial and multifamily real estate	232	157	389	54	335	459	401	8
Commercial and industrial	123	96	219	19	200	258	166	2
Total commercial lending	355	253	608	73	535	717	567	10
Small-ticket commercial real estate	10	30	40	2	38	62	35	1
Total commercial banking	365	283	648	75	573	779	602	11
Total	\$ 1,490	\$ 309	\$ 1,799	\$ 458	\$ 1,341	\$ 1,914	\$ 1,678	\$ 102

<sup>(1)</sup> Credit card and Installment loans include finance charges and fees.

TDR loans accounted for \$1.5 billion and \$1.6 billion of impaired loans as of June 30, 2012 and December 31, 2011, respectively. Consumer TDR loans classified as performing totaled \$1.1 billion, respectively, as of June 30, 2012, and December 31, 2011. Commercial TDR loans classified as performing totaled \$281 million, and \$305 million, respectively, as of June 30, 2012 and December 31, 2011.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

As part of our loan modifications to borrowers experiencing financial difficulty, we may provide multiple concessions to minimize our economic loss and improve long-term loan performance and collectability. The following tables present the types, amounts and financial effects of loans modified and accounted for as troubled debt restructurings during the period:

(Dollars in millions)	Three Months Ended June 30, 2012						
	Total Loans Modified <sup>(1)</sup>	% of TDR Activity <sup>(2)(8)</sup>	Reduced Interest Rate Average Rate Reduction <sup>(3)</sup>	Term Extension % of TDR Activity <sup>(4)(8)</sup>	Average Term Extension (Months) <sup>(5)</sup>	Balance Reduction % of TDR Activity <sup>(6)(8)</sup>	Gross Balance Reduction <sup>(7)</sup>
<b>Credit card:</b>							
Domestic credit card	\$ 88	100%	11.09%	0%	0	0%	\$ 0
International credit card	51	100	24.12	0	0	0	0
Total credit card	139	100	15.88	0	0	0	0
<b>Consumer banking:</b>							
Auto	20	72	1.40	100	10	0	0
Home loan	12	67	2.32	74	108	5	0
Retail banking	7	1	2.99	99	10	0	0
Total consumer banking	39	57	1.73	92	34	2	0
<b>Commercial banking:</b>							
Commercial and multifamily real estate	4	100	1.75	100	30	0	0
Commercial and industrial	32	1	1.36	100	9	0	0
Total commercial lending	36	13	1.71	100	12	0	0
Small-ticket commercial real estate	0	0	0.00	0	0	0	0
Total commercial banking	36	13	1.71	100	12	0	0
<b>Other:</b>							
Other loans	0	0	0.00	0	0	0	0
Total	\$ 214	78%	13.57%	33%	23	0%	\$ 0

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	Six Months Ended June 30, 2012						
	Total Loans Modified <sup>(1)</sup>	% of TDR Activity <sup>(2)(8)</sup>	Average Rate Reduction <sup>(3)</sup>	% of TDR Activity <sup>(4)(8)</sup>	Average Term Extension (Months) <sup>(5)</sup>	Balance Reduction % of TDR Activity <sup>(6)(8)</sup>	Gross Balance Reduction <sup>(7)</sup>
<b>Credit card:</b>							
Domestic credit card	\$ 145	100%	10.84%	0%	0	0%	\$ 0
International credit card	115	100	24.08	0	0	0	0
Total credit card	260	100	15.70	0	0	0	0
<b>Consumer banking:</b>							
Auto	45	71	1.40	100	10	0	0
Home loan	17	55	2.11	67	113	5	0
Retail banking	14	1	3.00	99	11	0	0
Total consumer banking	76	54	1.57	92	27	1	0
<b>Commercial banking:</b>							
Commercial and multifamily real estate	28	16	1.71	100	10	0	0
Commercial and industrial	66	6	6.62	99	12	0	0
Total commercial lending	94	9	4.04	99	11	0	0
Small-ticket commercial real estate	0	0	0.00	0	0	0	0
Total commercial banking	94	9	4.04	99	11	0	0
<b>Other:</b>							
Other loans	0	0	0.00	0	0	0	0
Total	\$ 430	72%	13.49%	38%	18	0%	\$ 0

(1) Represents total loans modified and accounted for as a TDR during the period. Paydowns, charge-offs and any other changes in the loan carrying value subsequent to the loan entering TDR status are not reflected.

(2) Percentage of loans modified and accounted for as a TDR during the period that were granted a reduced interest rate.

(3) Weighted average interest rate reduction for those loans that received an interest rate concession.

(4) Percentage of loans modified and accounted for as a TDR during the period that were granted a maturity date extension.

(5) Weighted average change in maturity date for those loans that received a maturity date extension.

(6) Percentage of loans modified and accounted for as a TDR during the period that were granted forgiveness or forbearance of a portion of their balance.

(7) Total amount of forgiven or forborne balances.

(8) Due to multiple concessions granted to some troubled borrowers, percentages may total more than 100% for certain loan types.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****TDR Subsequent Payment Defaults of Completed TDR Modifications**

The following table presents the type, number and amount of loans accounted for as TDRs that experienced a payment default during the period and had completed a modification event in the twelve months prior to the payment default. A payment default occurs if the loan is either 90 days or more delinquent or the loan has been charged-off as of the end of the period presented.

(Dollars in millions)	June 30, 2012			
	Three Months Ended		Six Months Ended	
	Number of Contracts	Total Loans	Number of Contracts	Total Loans
<b>Credit card:</b>				
Domestic credit card	9,541	\$ 19	18,170	\$ 39
International credit card <sup>(1)</sup>	12,945	44	25,053	87
Total credit card	22,486	63	43,223	126
<b>Consumer banking:</b>				
Auto	1,033	9	1,865	17
Home loan	31	3	67	6
Retail banking	26	1	69	7
Total consumer banking	1,090	13	2,001	30
<b>Commercial banking:</b>				
Commercial and multifamily real estate	2	6	5	8
Commercial and industrial	3	2	8	15
Total commercial lending	5	8	13	23
Small-ticket commercial real estate	0	0	3	2
Total commercial banking	5	8	16	25
Total	23,581	\$ 84	45,240	\$ 181

<sup>(1)</sup> The regulatory regime in the United Kingdom ( U.K. ) requires U.K. credit card businesses to accept payment plan proposals even when the proposed payments are less than the contractual minimum amount. As a result, loans entering long-term TDR payment programs in the U.K. typically continue to age and ultimately charge-off even when fully in compliance with the TDR program terms.

**Initial Fair Value and Accretable Yield of Acquired Loans**

At acquisition of ING Direct and HSBC's U.S. credit card business, we estimated the cash flows we expected to collect on these loans. Under the accounting guidance for loans acquired in a transfer, including a business combination, the difference between the contractually required

payments and the cash flows expected to be collected at acquisition is referred to as the nonaccretable difference.

This difference is neither accreted into income nor recorded on our consolidated balance sheet. We apply judgmental prepayment assumptions to both contractually required payments and cash flows expected to be collected at acquisition. The excess of cash flows expected to be collected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan, or pool of loans, using the effective yield method. The table below displays the contractually required principal and

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

interest, cash flows expected to be collected and fair value at acquisition related to the ING Direct loans we acquired that are accounted for based on expected cash flows. The table also displays the nonaccretable difference and the accretable yield at acquisition.

(Dollars in millions)	At Acquisition on February 17, 2012		
	Total	Impaired Loans	Non- Impaired Loans
Contractually required principal and interest at acquisition	\$ 50,649	\$ 3,605	\$ 47,044
Less: Nonaccretable difference	(4,443)	(2,343)	(2,100)
Cash flows expected to be collected at acquisition <sup>(1)</sup>	46,206	1,262	44,944
Less: Accretable yield	(6,644)	(94)	(6,550)
Fair value of loans acquired <sup>(2)(3)</sup>	\$ 39,562	\$ 1,168	\$ 38,394

<sup>(1)</sup> Represents undiscounted expected principal and interest cash flows at acquisition.

<sup>(2)</sup> A portion of the loans acquired in connection with the ING Direct acquisition is accounted for based on the loans contractual cash flows rather than the expected cash flows. These loans, which had an estimated fair value at acquisition of \$559 million, are not included in the above tables. The contractual cash flows for these loans at acquisition was \$858 million of which we do not expect to collect \$15 million.

<sup>(3)</sup> A portion of the loans acquired in connection with the ING Direct acquisition was classified as held for sale. These loans, which had an estimated fair value at acquisition of \$367 million, are not included in the above tables. The contractual cash flows for these loans at acquisition was \$384 million, of which we do not expect to collect \$16 million.

The table below displays the contractually required principal and interest, cash flows expected to be collected and fair value at acquisition related to the HSBC U.S. credit card business we acquired that are accounted for based on expected cash flows. The table also displays the nonaccretable difference and the accretable yield at acquisition.

(Dollars in millions)	At Acquisition on May 1, 2012	
	Impaired Loans	
Contractually required principal and interest at acquisition	\$ 1,537	
Less: Nonaccretable difference	(741)	
Cash flows expected to be collected at acquisition <sup>(1)</sup>	796	
Less: Accretable yield	(145)	
Fair value of loans acquired <sup>(2)(3)</sup>	\$ 651	

<sup>(1)</sup> Represents undiscounted expected cash flows of principal interest, finance charges, and fees at acquisition.

<sup>(2)</sup> The majority of the loans acquired in connection with the HSBC U.S. card acquisition retained revolving privileges. As such, the accounting for these loans is based on the contractual cash flows of the loans rather than the expected cash flows. These loans, which had an estimated

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

fair value at acquisition of \$26.9 billion, are not included in the above table.

- <sup>(3)</sup> A portion of the loans acquired in connection with the HSBC U.S. card acquisition was classified as held for sale. These loans, which had an estimated fair value of \$471 million at acquisition, are not included in the table above.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)*****Outstanding Balance and Carrying Value of Acquired Loans***

The table below presents the outstanding contractual balance and the carrying value of the HSBC U.S. credit card business, ING Direct and Chevy Chase Bank acquired loans as of June 30, 2012 and December 31, 2011:

(Dollars in millions)	June 30, 2012			December 31, 2011		
	Total	Impaired Loans	Non-Impaired Loans	Total	Impaired Loans	Non-Impaired Loans
Contractual balance	\$ 44,310	\$ 7,409	\$ 36,901	\$ 5,751	\$ 4,565	\$ 1,186
Carrying value <sup>(1)</sup>	\$ 41,733	\$ 4,778	\$ 36,955	\$ 4,658	\$ 3,576	\$ 1,082

<sup>(1)</sup> Includes \$38 million and \$27 million of cumulative impairment recognized as of June 30, 2012 and December 31, 2011, respectively.

***Changes in Accretable Yield of Acquired Loans***

Subsequent to acquisition, we are required to periodically evaluate our estimate of cash flows expected to be collected. These evaluations, performed quarterly, require the continued use of key assumptions and estimates, similar to the initial estimate of fair value. Subsequent changes in the estimated cash flows expected to be collected may result in changes in the accretable yield and nonaccretable difference or reclassifications from nonaccretable yield to accretable. Increases in the cash flows expected to be collected will generally result in an increase in interest income over the remaining life of the loan or pool of loans. Decreases in expected cash flows due to further credit deterioration will generally result in an impairment charge recognized in our provision for loan and lease losses, resulting in an increase to the allowance for loan losses. We decreased the allowance related to these pools of loans by \$2 million and increased the allowance related to these pools of loans by \$11 million for the three and six months ended June 30, 2012, respectively. We recorded a benefit through our provision for credit losses of \$2 million and recorded an impairment of \$0 million for the three months ended June 30, 2012 and 2011, respectively and recorded an impairment of \$11 million and \$8 million for the six months ended June 30, 2012 and 2011, respectively, related to acquired loans. The cumulative impairment recognized on acquired loans totaled \$37 million as of June 30, 2012 and \$26 million as of December 31, 2011.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table presents changes in the accretable yield related to the acquired HSBC U.S. card business, ING Direct and Chevy Chase Bank loans:

(Dollars in millions)	Total	Impaired Loans	Non- Impaired Loans
Accretable yield as of December 31, 2010	\$ 2,012	\$ 1,754	\$ 258
Accretion recognized in earnings	(431)	(365)	(66)
Reclassifications from nonaccretable difference for loans with improvement in expected cash flows <sup>(1)</sup>	237	232	5
Reductions in accretable yield for non-credit related changes in expected cash flows <sup>(2)</sup>	(66)	(55)	(11)
Accretable yield as of December 31, 2011	1,752	1,566	186
Acquired loans accretable yield	6,777	227	6,550
Accretion recognized in earnings	(632)	(178)	(454)
Reclassifications from nonaccretable difference for loans with improvement in expected cash flows <sup>(1)</sup>	110	101	9
Reductions in accretable yield for non-credit related changes in expected cash flows <sup>(2)</sup>	3	(1)	4
Accretable yield as of June 30, 2012	\$ 8,010	\$ 1,715	\$ 6,295

<sup>(1)</sup> Represents increases in accretable yields for those pools with increases primarily the result of improved credit performance.

<sup>(2)</sup> Represents changes in accretable yields for those pools with reductions driven primarily by changes in prepayment levels.

**Unfunded Lending Commitments**

We manage the potential risk in credit commitments by limiting the total amount of arrangements, both by individual customer and in total, by monitoring the size and maturity structure of these portfolios and by applying the same credit standards for all of our credit activities. Unused credit card lines available to our customers totaled \$305.3 billion and \$206.0 billion as of June 30, 2012 and December 31, 2011, respectively. While these amounts represented the total available unused credit card lines, we have not experienced, and do not anticipate, that all of our customers will access their entire available line at any given point in time.

In addition to available unused credit card lines, we enter into commitments to extend credit that are legally binding conditional agreements having fixed expirations or termination dates and specified interest rates and purposes. These commitments generally require customers to maintain certain credit standards. Collateral requirements and loan-to-value ratios are the same as those for funded transactions and are established based on management's credit assessment of the customer. These commitments may expire without being drawn upon.

Therefore, the total commitment amount does not necessarily represent future funding requirements. The outstanding unfunded commitments to extend credit other than credit card lines were approximately \$16.9 billion and \$14.8 billion as of June 30, 2012 and December 31, 2011, respectively.

We maintain a reserve for unfunded loan commitments and letters of credit to absorb estimated probable losses related to these unfunded credit facilities in other liabilities, on our consolidated balance sheets. Our reserve for unfunded loan commitments and letters of credit was \$51 million and \$66 million as of June 30, 2012 and December 31, 2011, respectively. See Note 6 Allowance for Loan and Lease Losses below for additional information.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****NOTE 6 ALLOWANCE FOR LOAN AND LEASE LOSSES**

We maintain an allowance for loan and lease losses ( the allowance ) that represents management's best estimate of incurred loan and lease credit losses inherent in our held-for-investment portfolio as of each balance sheet date. We do not maintain an allowance for held for sale loans or acquired loans that are performing in accordance with or better than our expectations as of the date of acquisition, as the fair values of these loans already reflect a credit component.

In addition to the allowance for loan and lease losses, we also estimate probable losses related to unfunded lending commitments, such as letters of credit and financial guarantees, and binding unfunded loan commitments. The provision for unfunded lending commitments is included in the provision for credit losses on our consolidated statements of income and the related reserve for unfunded lending commitments is included in other liabilities on our consolidated balance sheets. See Note 1 Summary of Significant Accounting Policies in our 2011 Form 10-K for a description of the methodologies and policies for determining our allowance for loan and lease losses for each of our loan portfolio segments.

**Allowance for Loan and Lease Losses Activity**

The allowance for loan and lease losses is increased through the provision for credit losses and reduced by net charge-offs. The provision for credit losses, which is charged to earnings, reflects credit losses we believe have been incurred and will eventually be reflected over time in our charge-offs. Charge-offs of uncollectible amounts are deducted from the allowance and subsequent recoveries are included. The table below summarizes changes in the allowance for loan and lease losses, by portfolio segment, for the three and six months ended June 30, 2012 and 2011:

(Dollars in millions)	Three Months Ended June 30, 2012								Allowance for Loan and Lease Losses	Unfunded Lending Commitments Reserve	Allowance for Credit Losses
	Consumer										
	Credit Card	Auto	Home Loan	Retail Banking	Total Consumer	Commercial	Other <sup>(1)</sup>				
Balance as of March 31, 2012	\$ 2,671	\$ 459	\$ 102	\$ 157	\$ 718	\$ 636	\$ 35	\$ 4,060	\$ 60	\$ 4,120	
Provision for credit losses	1,711	56	(3)	(9)	44	(84)	15	1,686	(9)	1,677	
Charge-offs	(908)	(122)	(19)	(20)	(161)	(24)	(7)	(1,100)	0	(1,100)	
Recoveries	286	54	7	7	68	7	1	362	0	362	
Net charge-offs	(622)	(68)	(12)	(13)	(93)	(17)	(6)	(738)	0	(738)	
Other changes	(10)	0	0	0	0	0	0	(10)	0	(10)	
Balance as of June 30, 2012	\$ 3,750	\$ 447	\$ 87	\$ 135	\$ 669	\$ 535	\$ 44	\$ 4,998	\$ 51	\$ 5,049	

(Dollars in millions)	Six Months Ended June 30, 2012								Allowance for Loan and Lease Losses	Unfunded Lending Commitments Reserve	Allowance for Credit Losses
	Consumer										
	Credit Card	Auto	Home Loan	Retail Banking	Total Consumer	Commercial	Other <sup>(1)</sup>				
Balance as of March 31, 2012	\$ 2,671	\$ 459	\$ 102	\$ 157	\$ 718	\$ 636	\$ 35	\$ 4,060	\$ 60	\$ 4,120	
Provision for credit losses	1,711	56	(3)	(9)	44	(84)	15	1,686	(9)	1,677	
Charge-offs	(908)	(122)	(19)	(20)	(161)	(24)	(7)	(1,100)	0	(1,100)	
Recoveries	286	54	7	7	68	7	1	362	0	362	
Net charge-offs	(622)	(68)	(12)	(13)	(93)	(17)	(6)	(738)	0	(738)	
Other changes	(10)	0	0	0	0	0	0	(10)	0	(10)	
Balance as of June 30, 2012	\$ 3,750	\$ 447	\$ 87	\$ 135	\$ 669	\$ 535	\$ 44	\$ 4,998	\$ 51	\$ 5,049	

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Balance as of December 31, 2011	\$ 2,847	\$ 391	\$ 98	\$ 163	\$ 652	\$ 715	\$ 36	\$ 4,250	\$ 66	\$ 4,316
Provision for credit losses	2,170	203	16	(1)	218	(147)	24	2,265	(15)	2,250
Charge-offs	(1,863)	(262)	(43)	(40)	(345)	(60)	(18)	(2,286)	0	(2,286)
Recoveries	595	115	16	13	144	27	2	768	0	768
Net charge-offs	(1,268)	(147)	(27)	(27)	(201)	(33)	(16)	(1,518)	0	(1,518)
Other changes	1	0	0	0	0	0	0	1	0	1
Balance as of June 30, 2012	\$ 3,750	\$ 447	\$ 87	\$ 135	\$ 669	\$ 535	\$ 44	\$ 4,998	\$ 51	\$ 5,049

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	Three Months Ended June 30, 2011							Allowance for Loan and Lease Losses	Unfunded Lending Commitments Reserve	Allowance For Credit Loans
	Consumer									
	Credit Card	Auto	Home Loans	Retail Banking	Total Consumer	Commercial	Other <sup>(1)</sup>			
Balance as of March 31, 2011	\$ 3,576	\$ 318	\$ 118	\$ 204	\$ 640	\$ 785	\$ 66	\$ 5,067	\$ 71	\$ 5,138
Provision for credit losses	309	56	(12)	1	45	(15)	11	350	(7)	343
Charge-offs	(1,110)	(102)	(22)	(25)	(149)	(50)	(13)	(1,322)	0	(1,322)
Recoveries	317	50	5	6	61	12	1	391	0	391
Net charge-offs	(793)	(52)	(17)	(19)	(88)	(38)	(12)	(931)	0	(931)
Other changes	1	0	1	0	1	0	0	2	0	2
Balance as of June 30, 2011	\$ 3,093	\$ 322	\$ 90	\$ 186	\$ 598	\$ 732	\$ 65	\$ 4,488	\$ 64	\$ 4,552

(Dollars in millions)	Six Months Ended June 30, 2011							Allowance for Loan and Lease Losses	Unfunded Lending Commitments Reserve	Allowance For Credit Loans
	Consumer									
	Credit Card	Auto	Home Loans	Retail Banking	Total Consumer	Commercial	Other <sup>(1)</sup>			
Balance as of December 31, 2010	\$ 4,041	\$ 353	\$ 112	\$ 210	\$ 675	\$ 830	\$ 82	\$ 5,628	\$ 107	\$ 5,735
Provision for credit losses	759	110	16	18	144	0	17	920	(43)	877
Charge-offs	(2,395)	(243)	(54)	(55)	(352)	(118)	(37)	(2,902)	0	(2,902)
Recoveries	673	102	16	13	131	20	2	826	0	826
Net charge-offs	(1,722)	(141)	(38)	(42)	(221)	(98)	(35)	(2,076)	0	(2,076)
Other changes	15	0	0	0	0	0	1	16	0	16
Balance as of June 30, 2011	\$ 3,093	\$ 322	\$ 90	\$ 186	\$ 598	\$ 732	\$ 65	\$ 4,488	\$ 64	\$ 4,552

<sup>(1)</sup> Other consists of our discontinued GreenPoint mortgage operations loan portfolio and our community redevelopment loan portfolio.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Components of Allowance for Loan and Lease Losses by Impairment Methodology**

The table below presents the components of our allowance for loan and lease losses, by loan category and impairment methodology, and the recorded investment of the related loans as of June 30, 2012 and December 31, 2011:

(Dollars in millions)	June 30, 2012							Total
	Credit Card	Auto	Consumer Home Loan	Retail Banking	Total Consumer	Commercial	Other	
<b>Allowance for loan and lease losses by impairment methodology:</b>								
Formula-based <sup>(1)</sup>	\$ 3,420	\$ 437	\$ 36	\$ 126	\$ 599	\$ 468	\$ 44	\$ 4,531
Asset-specific <sup>(2)</sup>	330	10	17	8	35	65	0	430
Acquired loans	0	0	34	1	35	2	0	37
Total allowance for loan and lease losses	\$ 3,750	\$ 447	\$ 87	\$ 135	\$ 669	\$ 535	\$ 44	\$ 4,998
<b>Held-for-investment loans by impairment methodology:</b>								
Formula-based <sup>(1)</sup>	\$ 87,526	\$ 25,146	\$ 7,476	\$ 4,012	\$ 36,634	\$ 35,003	\$ 164	\$ 159,327
Asset-specific <sup>(2)</sup>	859	75	106	87	268	622	0	1,749
Acquired loans	529	30	40,642	41	40,713	431	0	41,673
Total held-for-investment loans	\$ 88,914	\$ 25,251	\$ 48,224	\$ 4,140	\$ 77,615	\$ 36,056	\$ 164	\$ 202,749
Allowance as a percentage of period-end held-for-investment loans	4.22%	1.77%	0.18%	3.26%	0.86%	1.48%	26.83%	2.47%

(Dollars in millions)	December 31, 2011							Total
	Credit Card	Auto	Consumer Home Loan	Retail Banking	Total Consumer	Commercial	Other	
<b>Allowance for loan and lease losses by impairment methodology:</b>								
Formula-based <sup>(1)</sup>	\$ 2,494	\$ 383	\$ 65	\$ 150	\$ 598	\$ 638	\$ 36	\$ 3,766
Asset-specific <sup>(2)</sup>	353	8	10	12	30	75	0	458
Acquired loans	0	0	23	1	24	2	0	26
Total allowance for loan and lease losses	\$ 2,847	\$ 391	\$ 98	\$ 163	\$ 652	\$ 715	\$ 36	\$ 4,250
<b>Held-for-investment loans by impairment methodology:</b>								
Formula-based <sup>(1)</sup>	\$ 64,177	\$ 21,674	\$ 6,217	\$ 3,968	\$ 31,859	\$ 33,198	\$ 175	\$ 129,409

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Asset-specific <sup>(2)</sup>	898	58	104	90	252	648	0	1,798
Acquired loans	0	47	4,112	45	4,204	481	0	4,685
Total held-for-investment loans	\$ 65,075	\$ 21,779	\$ 10,433	\$ 4,103	\$ 36,315	\$ 34,327	\$ 175	\$ 135,892
Allowance as a percentage of period-end held-for-investment loans	4.37%	1.80%	0.94%	3.97%	1.80%	2.08%	20.57%	3.13%

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

- (1) The formula-based component of the allowance for credit card and other consumer loans that we collectively evaluate for impairment is based on a statistical calculation supplemented by judgment and interpretation. The formula-based component of the allowance for commercial loans that we collectively evaluate for impairment is based on our historical loss experience for loans with similar characteristics and consideration of credit quality supplemented by management judgment and interpretation.
- (2) The asset specific component of the allowance for smaller-balance impaired loans is calculated on a pool basis using historical loss experience for the respective class of assets. The asset-specific component of the allowance for larger-balance, commercial loans is individually calculated for each loan.

**NOTE 7 VARIABLE INTEREST ENTITIES AND SECURITIZATIONS**

In the normal course of business, we enter into various types of transactions with entities that are considered to be variable interest entities ( VIEs ). Historically, our primary involvement with VIEs related to our securitization transactions in which we transferred assets from our balance sheet to securitization trusts. These securitization trusts typically meet the definition of a VIE. We generally securitized credit card loans, auto loans, home loans and installment loans, which provided a source of funding for us and as a means of transferring a certain portion of the economic risk of the loans or debt securities to third parties.

Under revised consolidation accounting guidance that became effective on January 1, 2010, the entity that has a controlling financial interest in a VIE is referred to as the primary beneficiary and is required to consolidate the VIE. As a result of this guidance, the vast majority of the VIEs in which we are involved have been consolidated in our financial statements.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Summary of Consolidated and Unconsolidated VIEs**

The table below presents a summary of VIEs, aggregated based on VIEs with similar characteristics, in which we had continuing involvement or held a variable interest as of June 30, 2012 and December 31, 2011. We separately present information for consolidated and unconsolidated VIEs.

For consolidated VIEs, we present the carrying amount of assets and liabilities reflected on our consolidated balance sheets. The assets of consolidated VIEs primarily consist of cash and loans, which we report on our consolidated balance sheets under restricted cash for securitization investors and restricted loans for securitization investors, respectively. The assets of a particular VIE are the primary source of funds to settle its obligations. The creditors of the VIEs typically do not have recourse to the general credit of our company. The liabilities primarily consist of debt securities issued by the VIEs, which we report under securitized debt obligations. For unconsolidated VIEs, we present the carrying amount of assets and liabilities reflected on our consolidated balance sheets and our maximum exposure to loss. Our maximum exposure to loss is estimated based on the unlikely event that all of the assets in the VIEs became worthless and we were required to meet our maximum remaining funding obligations.

	Consolidated		June 30, 2012 Non-Consolidated		Maximum Exposure to Loss <sup>(3)</sup>
	Carrying Amount of Assets	Carrying Amount of Liabilities	Carrying Amount of Assets	Carrying Amount of Liabilities	
<b>(Dollars in millions)</b>					
<b>Securitization-related VIEs:</b>					
Credit card loan securitizations <sup>(4)</sup>	\$ 44,420	\$ 14,642	\$ 0	\$ 0	\$ 0
Auto loan securitizations <sup>(4)</sup>	0	0	0	0	0
Home loan securitizations	0	0	158 <sup>(1)</sup>	24 <sup>(2)</sup>	256
Other asset securitizations <sup>(4)</sup>	21	21	0	0	0
<b>Total securitization related VIEs</b>	<b>44,441</b>	<b>14,663</b>	<b>158</b>	<b>24</b>	<b>256</b>
<b>Other VIEs:</b>					
Affordable housing entities	0	0	2,209	300	2,209
Entities that provide capital to low-income and rural communities	258	0	6	4	6
Other	1	0	213	86	213
<b>Total Other VIEs</b>	<b>259</b>	<b>0</b>	<b>2,428</b>	<b>390</b>	<b>2,428</b>
<b>Total VIEs</b>	<b>\$ 44,700</b>	<b>\$ 14,663</b>	<b>\$ 2,586</b>	<b>\$ 414</b>	<b>\$ 2,684</b>

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

	Consolidated		December 31, 2011		Maximum Exposure to Loss <sup>(3)</sup>
	Carrying Amount of Assets	Carrying Amount of Liabilities	Carrying Amount of Assets	Carrying Amount of Liabilities	
<b>(Dollars in millions)</b>					
<b>Securitization-related VIEs:</b>					
Credit card loan securitizations <sup>(4)</sup>	\$ 48,309	\$ 17,443	\$ 0	\$ 0	\$ 0
Auto loan securitizations <sup>(4)</sup>	95	78	0	0	0
Home loan securitizations	0	0	161 <sup>(1)</sup>	27 <sup>(2)</sup>	269
Other asset securitizations <sup>(4)</sup>	36	36	0	0	0
Total securitization related VIEs	48,440	17,557	161	27	269
<b>Other VIEs:</b>					
Affordable housing entities	0	0	2,044	289	2,044
Entities that provide capital to low-income and rural communities	258	0	6	3	6
Other	1	0	139	0	139
Total Other VIEs	259	0	2,189	292	2,189
Total VIEs	\$ 48,699	\$ 17,557	\$ 2,350	\$ 319	\$ 2,458

(1) The carrying amount of assets of unconsolidated securitization-related VIEs consists of retained interests and letters of credit related to manufactured housing securitizations and are reported on our consolidated balance sheets under accounts receivable from securitizations. Mortgage servicing rights related to unconsolidated VIEs are reported on our consolidated balance sheets under other assets. See Note 8 Goodwill and Other Intangible Assets for additional information on our mortgage servicing rights.

(2) The carrying amount of liabilities of securitization related VIEs is comprised of obligations to fund negative amortization bonds associated with the securitization of option arm mortgage loans ( option-ARMs ) and obligations on certain swap agreements associated with the securitization of manufactured housing loans.

(3) The maximum exposure to loss represents the amount of loss we would incur in the unlikely event that all of our assets in the VIE become worthless and we were required to meet our maximum remaining funding obligations.

(4) Represents the gross assets and liabilities owned by the VIE which included seller's interest and retained and repurchased notes held by other related parties.

**Securitization Related VIEs**

We historically have securitized credit card loans, auto loans, home loans and installment loans. In a securitization transaction, assets from our balance sheet are transferred to a trust we establish, which typically meets the definition of a VIE. The trust then issues various forms of interests in those assets to investors. We typically receive cash proceeds and/or other interests in the securitization trust for the assets we transfer. If the transfer of the assets to an unconsolidated securitization trust qualifies as a sale, we remove the assets from our consolidated balance sheet and recognize a gain or loss on the transfer. Alternatively, if the transfer does not qualify as a sale but instead is considered a secured borrowing or the transfer of assets is to a consolidated VIE, the assets remain on our consolidated financial statements and we record an offsetting liability for the proceeds received.

Our continuing involvement in the majority of our securitization transactions consists primarily of holding certain retained interests and acting as the primary servicer. We also may be required to repurchase receivables from the trust if the outstanding balance of the receivables falls to a level where the cost exceeds the benefits of servicing such receivables. We also may have exposure associated with contractual obligations to repurchase previously transferred loans due to breaches of representations and warranties. See Note 15 Commitments,



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

Contingencies and Guarantees for information related to reserves we have established for our potential mortgage representation and warranty exposure.

The table below presents the securitization-related VIEs in which we had continuing involvement as of June 30, 2012 and December 31, 2011:

(Dollars in millions)	Non-Mortgage				Mortgage	GreenPoint
	Credit Card	Auto Loan	Other Loan	Option Arm	GreenPoint HELOCs	Manufactured Housing
<b>June 30, 2012:</b>						
Securities held by third-party investors	\$ 13,595	\$ 0	\$ 13	\$ 2,913	\$ 181	\$ 1,181
Receivables in the trust	44,048	0	21	3,013	181	1,187
Cash balance of spread or reserve accounts	0	0	0	8	0	167
Retained interests	Yes	N/A	Yes	Yes	Yes	Yes
Servicing retained	Yes	N/A	Yes	Yes <sup>(1)</sup>	Yes <sup>(1)</sup>	No <sup>(3)</sup>
Amortization event <sup>(4)</sup>	No	N/A	No	No	Yes <sup>(2)</sup>	No
<b>December 31, 2011:</b>						
Securities held by third-party investors	\$ 16,428	\$ 75	\$ 24	\$ 3,122	\$ 206	\$ 1,247
Receivables in the trust	47,537	77	36	3,228	206	1,254
Cash balance of spread or reserve accounts	17	12	0	8	0	172
Retained interests	Yes	Yes	Yes	Yes	Yes	Yes
Servicing retained	Yes	Yes	Yes	Yes <sup>(1)</sup>	Yes <sup>(1)</sup>	No <sup>(3)</sup>
Amortization event <sup>(4)</sup>	No	No	No	No	Yes <sup>(2)</sup>	No

(1) We continue to service some of the outstanding balance of securitized mortgage receivables.

(2) See information below regarding on-going involvement in the GreenPoint Home Equity Line of Credit ( HELOC ) securitizations.

(3) The manufactured housing securitizations are serviced by a third party. For two of the deals, that third party works in the capacity of subservicer with Capital One being the Master Servicer.

(4) Amortization events vary according to each specific trust agreement but generally are triggered by declines in performance or credit metrics such as charge-off rates or delinquency rates below certain predetermined thresholds. Generally, the occurrence of an amortization event changes the sequencing and amount of trust related cash flows to the benefit of senior noteholders.

**Non-Mortgage Securitizations**

As of June 30, 2012 and December 31, 2011, we were deemed to be the primary beneficiary of all of our non-mortgage securitization trusts. Accordingly, all of these trusts have been consolidated in our financial statements. For additional information on our principal involvement with non-mortgage securitization trusts and the impact of the consolidation of these trusts on our financial statements, see Note 1 Summary of Significant Accounting Policies and Note 7 Variable Interest Entities and Securitizations of our 2011 Form 10-K.

**Mortgage Securitizations****Option-ARM Loans**

We had previously securitized option-ARM mortgage loans by transferring the mortgage loans to securitization trusts that had issued mortgage-backed securities to investors. The outstanding balance of debt securities held by third-party investors related to our mortgage loan securitization trusts was \$2.9 billion as of June 30, 2012 and \$3.1 billion as of December 31, 2011.



---

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

We continue to service some of the outstanding balance of securitized mortgage receivables. We also retain rights to future cash flows arising from the receivables, the most significant being certificated interest-only bonds issued by the trusts. We generally estimate the fair value of these retained interests based on the estimated present value of expected future cash flows from securitized and sold receivables, using our best estimates of the key assumptions which include credit losses, prepayment speeds and discount rates commensurate with the risks involved. We do not consolidate these trusts because we do not have the right to receive benefits that could potentially be significant nor the obligation to absorb losses that could potentially be significant to the trusts.

In connection with the securitization of certain option-ARM loans, a third party is obligated to advance a portion of any negative amortization resulting from monthly payments that are less than the interest accrued for that payment period. We have an agreement in place with the third party that mirrors this advance requirement. The amount advanced is tracked through mortgage-backed securities retained as part of the securitization transaction. As the borrowers make principal payments, these securities receive their net pro rata portion of those payments in cash, and advances of negative amortization are refunded accordingly. As advances occur, we record an asset in the form of negative amortization bonds, which are held at fair value in other assets. We have also entered into certain derivative contracts related to the securitization activities. These are classified as free standing derivatives, with fair value adjustments recorded in non-interest income. See Note 10 Derivative Instruments and Hedging Activities for further details on these derivatives.

*GreenPoint Mortgage HELOCs*

Our 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 trusts which securitized some of those loans. As the 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. We had funded \$28 million in advances as of June 30, 2012, all of which was expensed as funded. Our unfunded commitment related to these residual interests was \$9 million as of June 30, 2012. We have not consolidated these trusts because the residual certificates did not provide the obligation to absorb losses or the right to receive benefits that could potentially be significant to the trusts.

*GreenPoint Mortgage Manufactured Housing*

We retain the primary obligation for certain provisions of corporate guarantees, recourse sales and clean-up calls related to the discontinued manufactured housing operations of GreenPoint Credit LLC ( GPC ) which was sold to a third party in 2004. Although we are the primary obligor, recourse obligations related to former GPC whole loan sales, commitments to exercise mandatory clean-up calls on certain GPC securitization transactions and servicing were transferred to a third party in the sale transaction. We do not consolidate the trusts used for the securitization of manufactured housing loans because we do not have the power to direct the activities that most significantly impact the economic performance of the trusts since we no longer service the loans.

We were required to fund letters of credit in 2004 to cover losses, and are obligated to fund future amounts under swap agreements for certain transactions. We have the right to receive any funds remaining in the letters of credit after the securities are released. The amount available under the letters of credit was \$167 million and \$172 million as of June 30, 2012 and December 31, 2011, respectively. The fair value of the expected residual balances on the funded letters of credit was \$51 million as of June 30, 2012 and December 31, 2011, and is included in other assets on the consolidated balance sheet. Our maximum exposure under the swap agreements was \$21 million and \$23 million as of June 30, 2012 and December 31, 2011, respectively. The value of our obligations under these swaps was \$13 million and \$12 million as of June 30, 2012 and December 31, 2011, respectively and is recorded in other liabilities on our consolidated balance sheet.

Table of Contents

## CAPITAL ONE FINANCIAL CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

The unpaid principal balance of manufactured housing securitization transactions where we are the residual interest holder was \$1.2 billion and \$1.3 billion as of June 30, 2012 and December 31, 2011, respectively. In the event the third party does not fulfill on its obligations to exercise the clean-up calls on certain transactions, the obligation reverts to us and we would assume approximately \$420 million of loans receivable upon our execution of the clean-up call with the requirement to absorb any losses on the loans receivable. There have been no instances of non-performance to date by the third party.

We monitor the underlying assets for trends in delinquencies and related losses and review the purchaser's financial strength as well as servicing performance. These factors are considered in assessing the adequacy of the liabilities established for these obligations and the valuations of the assets.

*Retained Interests in Unconsolidated Securitizations**Accounts Receivable from Securitizations*

Retained interests in unconsolidated securitizations are included in accounts receivable from securitizations on our consolidated balance sheets. These retained interests consist of interest-only strips, retained tranches, cash collateral accounts, cash reserve accounts and unpaid interest and fees on the third-party investors' portion of the transferred principal receivables.

The following table provides details of accounts receivable from securitizations as of June 30, 2012 and December 31, 2011:

(Dollars in millions)	June 30, 2012	December 31, 2011
Interest-only strip classified as trading	\$ 63	\$ 63
Retained interests classified as trading:		
Retained notes	26	23
Cash collateral	8	8
<b>Total retained interests classified as trading</b>	<b>34</b>	<b>31</b>
<b>Total accounts receivable from securitizations</b>	<b>\$ 97</b>	<b>\$ 94</b>

We may retain tranches in certain of the securitization transactions which are considered to be higher investment grade securities and subject to lower risk of loss. Those retained tranches are classified as available-for-sale securities, and changes in the estimated fair value are recorded in other comprehensive income.

The components of the net gains (losses) recognized as a result of changes in the fair value of retained interests are presented below:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Interest only strip valuation changes	\$ (3)	\$ (4)	\$ (1)	\$ (7)
Fair value adjustments related to spread accounts	11	12	22	25
Fair value adjustments related to investors' accrued interest receivable	0	0	0	0
Fair value adjustments related to retained subordinated notes	0	(17)	(3)	1

Net gain recognized in earnings	\$ 8	\$ (9)	\$ 18	\$ 19
---------------------------------	------	--------	-------	-------



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The changes in the fair value of retained interests are primarily driven by rate assumption changes and volume fluctuations. All of these retained residual interests are subject to loss in the event assumptions used to determine the estimated fair value do not prevail, or if borrowers default on the related securitized receivables and our retained subordinated tranches are used to repay investors. See the table below for key assumptions and sensitivities for retained interest valuations.

*Key Assumptions and Sensitivities for Retained Interest Valuations*

The key assumptions used in determining the fair value of the interest-only strip and other retained residual interests include the weighted average ranges for principal payment rates, lives of receivables and discount rates, all of which are included in the following table. The principal repayment rate assumptions were determined using actual and forecast trust principal payment rates based on the collateral. The lives of receivables were determined as the number of months necessary to repay the investors given the principal payment rate assumptions. The discount rates were determined using primarily trust specific statistics and forward rate curves, and were reflective of what market participants would use in a similar valuation. Additionally, accrued interest receivable, cash reserve and spread accounts were discounted over the estimated life of the assets.

If these assumptions are not met, or if they change, the interest-only strip, retained interests and related servicing and securitizations income would be affected. The following adverse changes to the key assumptions and estimates are hypothetical and should be used with caution. As the figures indicate, any change in fair value based on a 10% or 20% variation in assumptions cannot be extrapolated because the relationship of a change in assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the interest-only strip is calculated independently from any change in another assumption. However, changes in one factor may result in changes in other factors, which might magnify or counteract the sensitivities.

For the periods ending June 30, 2012 and December 31, 2011, the assumptions and sensitivities shown below include all off-balance sheet securitizations:

<b>(Dollars in millions)</b>	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Interest-only strip retained interests	\$ 107 <sup>(1)</sup>	\$ 110 <sup>(1)</sup>
Weighted average life for receivables (months)	62	70
Principal repayment rate (weighted average rate)	11.4-12.7%	12.2 17.1%
Impact on fair value of 10% adverse change	\$ (2)	\$ 15
Impact on fair value of 20% adverse change	(5)	(5)
Discount rate (weighted average rate)	25.1-42.2%	25.0 42.2%
Impact on fair value of 10% adverse change	\$ (6)	\$ (7)
Impact on fair value of 20% adverse change	(11)	(13)

<sup>(1)</sup> Does not include liquidity swap related to the negative amortization bonds of \$(11) million and \$(16) million as of June 30, 2012 and December 31, 2011, respectively.

Static pool credit losses were calculated by summing the actual and projected future credit losses and dividing them by the original balance of each pool of assets. Due to the short-term revolving nature of the loan receivables, the weighted average percentage of static pool credit losses was not considered materially different from the assumed charge-off rates used to determine the fair value of the retained interests.

We act as a servicing agent and receive contractual servicing fees of between 0.375% and 1% of the investor principal outstanding, based upon the type of assets serviced. For off-balance sheet securitizations, we generally did not record material servicing assets or liabilities for these rights since the contractual servicing fee approximates market rates.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)***Cash Flows Related to the Unconsolidated Securitizations*

The following provides the details of the cash flows related to securitization transactions that qualified as off-balance sheet for the three and six months ended June 30, 2012 and 2011:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Servicing fees received	\$ 7	\$ 7	\$ 14	\$ 15
Cash flows received on retained interests <sup>(1)</sup>	10	12	20	25

<sup>(1)</sup> Includes all cash receipts of excess spread and other payments (excluding servicing fees) from the program.

*Supplemental Loan Information*

The table below displays the unpaid principal balance of off-balance sheet single-family residential loans we serviced as of June 30, 2012 and December 31, 2011. We also display the unpaid principal balance of loans past due 90 days or more as of June 30, 2012 and December 31, 2011. Net credit losses associated with these loans totaled \$18 million and \$22 million for the six months ended June 30, 2012 and 2011, respectively.

(Dollars in millions)	June 30, 2012	December 31, 2011
Total principal amount of loans	\$ 1,146	\$ 1,220
Principal amount of loans past due 90 days or more	208	223
<b>Other VIEs</b>		

*Affordable Housing Entities*

As part of our community reinvestment initiatives, we invest in private investment funds that make equity investments in multi-family affordable housing properties. We receive affordable housing tax credits for these investments. The activities of these entities are financed with a combination of invested equity capital and debt. For those investment funds considered to be VIEs, we are not required to consolidate if we do not have the power to direct the activities that most significantly impact the economic performance of those entities. We record our interests in these unconsolidated VIEs in loans held for investment, other assets and other liabilities. As of June 30, 2012 and December 31, 2011 our interests consisted of assets of approximately \$2.2 billion and \$2.0 billion, respectively. Our maximum exposure to these entities is limited to our variable interests in the entities and is \$2.2 billion as of June 30, 2012. The creditors of the VIEs have no recourse to our general credit and we do not provide additional financial or other support during the period that we were not previously contractually required to provide. The total assets of the unconsolidated investment funds that were VIEs at June 30, 2012 and December 31, 2011 were approximately \$9.5 billion and \$8.4 billion, respectively.

*Entities that Provide Capital to Low-Income and Rural Communities*

We hold variable interests in entities ( Investor Entities ) that invest in community development entities ( CDEs ) that provide debt financing to businesses and non-profit entities in low-income and rural communities. Variable interests in the CDEs held by the consolidated Investor Entities are also our variable interests. The activities of the Investor Entities are financed with a combination of invested equity capital and debt. The activities of the CDEs are financed solely with invested equity capital. We receive federal and state tax credits for these investments. We consolidate the VIEs in which we have the power to direct the activities that most significantly impact the VIE s economic performance and the

obligation to absorb losses or right to receive

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

benefits that could be potentially significant to the VIE. We have also consolidated other investments and CDEs that we do not consider VIEs. The assets of the VIEs that we consolidated at June 30, 2012 and December 31, 2011 totaled approximately \$258 million. The assets of the consolidated VIEs are reflected on our consolidated balance sheets in cash, loans held for investment, interest receivable and other assets. The liabilities are reflected in other liabilities.

The total assets of the VIEs that we held an interest in, but were not required to consolidate as of June 30, 2012 and December 31, 2011 totaled approximately \$6 million. Our interests in these unconsolidated VIEs are reflected on our consolidated balance sheets in loans held for investment and other assets. Our maximum exposure to these entities is limited to our variable interest of \$6 million as of June 30, 2012. The creditors of the VIEs have no recourse to our general credit. We have not provided additional financial or other support during the period that we were not previously contractually required to provide.

***Other***

We have a variable interest in Capital One Financial Advisors, LLC which we consolidate as we have the power to direct the activities that most significantly impact the VIE's economic performance and the obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. The assets of the VIE that we consolidated totaled approximately \$1 million as of June 30, 2012 and December 31, 2011, respectively. The assets are consolidated in our balance sheet in cash and other assets.

We also have a variable interest in a trust that has a royalty interest in certain oil and gas properties. The activities of the trust are financed solely with debt. The total assets of the trust were \$282 million and \$309 million as of June 30, 2012 and December 31, 2011, respectively. We were not required to consolidate the trust because we do not have the power to direct the activities of the trust that most significantly impact the trust's economic performance. Our retained interest in the trust, which totaled approximately \$126 million and \$139 million as of June 30, 2012 and December 31, 2011, respectively, is reflected on our consolidated balance sheets under loans held for investment. Our maximum exposure is limited to our variable interest of \$126 million as of June 30, 2012. The creditors of the trust have no recourse to our general credit. We have not provided additional financial or other support during the period that we were not previously contractually required to provide.

In April 2012, we purchased membership interests in three limited liability companies that each operates a refined coal production facility. The sale of this refined coal qualifies for tax credits pursuant to Section 45 of the Internal Revenue Code. In the aggregate, we paid \$1 million in cash at closing and agreed to a fixed note payable of \$86 million and additional quarterly variable payments based on the amount of tax credits to be generated by these entities from April 2012 to 2021. In addition, we have an ongoing commitment to fund a proportionate share of the operating expenses of each of these entities based on our ownership percentage. These limited liability companies were deemed to be VIEs and we determined that we were not the primary beneficiary as we do not have the power to direct the activities of these entities that most significantly impact their economic performance. Our membership interests in these entities are reflected on our consolidated balance sheet within other assets. As of June 30, 2012, the carrying value of our aggregate membership interest in these entities was \$87 million. Our future obligation to these entities is predicated upon the generation of tax credits and their operating performance in future periods. The parties involved with these entities have recourse to our general credit for the quarterly variable payment amounts and ongoing funding commitments that become payable to them. These payments will only be required if the refined coal production facilities are either currently generating tax credits or expect to generate them imminently. We have not provided additional financial or other support during the period that we were not contractually required to provide.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****NOTE 8 GOODWILL AND OTHER INTANGIBLE ASSETS**

The table below displays the components of goodwill and other intangible assets, including mortgage servicing rights, as of June 30, 2012 and December 31, 2011:

(Dollars in millions)	June 30, 2012	December 31, 2011
Goodwill	\$ 13,864	\$ 13,592
Other intangible assets:		
Purchased credit card relationship intangibles <sup>(1)</sup>	2,090	52
Core deposit intangibles <sup>(2)</sup>	591	479
Other	280	79
Total other intangible assets	2,961	610
Total goodwill and other intangible assets	\$ 16,825	\$ 14,202
Mortgage servicing rights	\$ 84	\$ 93

<sup>(1)</sup> Includes purchased credit card relationship intangibles with a net carrying value of \$2.0 billion related to the HSBC U.S. acquisition.

<sup>(2)</sup> Includes core deposit intangibles with net carrying value of \$187 million related to the acquisition of ING Direct in the first quarter of 2012.

**Goodwill**

In accordance with accounting guidance, goodwill is not amortized but is tested for impairment at the reporting unit level, which is at the operating segment level or one level below an operating segment. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. Goodwill is required to be tested for impairment annually and between annual tests if events or circumstances change, such as adverse changes in the business climate, that would more likely than not reduce the fair value of the reporting unit below its carrying value. Goodwill is assigned to one or more reporting units at the date of acquisition. Our reporting units are Domestic Credit Card, International Credit Card, Auto Finance, other Consumer Banking and Commercial Banking. As of June 30, 2012 and December 31, 2011, goodwill of \$13.9 billion and \$13.6 billion, respectively, was included in the accompanying consolidated balance sheets. There were no events requiring an interim impairment test and there has been no goodwill impairment recorded for the three and six months ended June 30, 2012. The goodwill impairment test, performed at October 1 of each year, is a two-step test. The first step identifies whether there is potential impairment by comparing the fair value of a reporting unit to the carrying amount, including goodwill. If the fair value of a reporting unit is less than its carrying amount, the second step of the impairment test is required to measure the amount of any impairment loss.

During the second quarter of 2012, we acquired the assets and assumed the liabilities of the credit card and private label credit card business of HSBC. In connection with the acquisition, we recorded goodwill of \$272 million representing the amount by which the purchase price exceeded the fair value of the net assets acquired. The goodwill was assigned to the Credit Card segment. See Note 2 Acquisitions for information regarding the HSBC U.S. Card acquisition.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table presents a summary of changes in goodwill by segment, for the six months ended June 30, 2012.

(Dollars in millions)	Credit Card	Consumer	Commercial	Total
<b>Total Company</b>				
Balance as of December 31, 2011	\$ 4,691	\$ 4,583	\$ 4,318	\$ 13,592
Acquisitions	272	0	0	272
Balance as of June 30, 2012	\$ 4,963	\$ 4,583	\$ 4,318	\$ 13,864

**Other Intangible Assets**

In connection with our acquisitions, we recorded intangible assets which 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 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.

In connection with the February 17, 2012 acquisition of ING Direct, we recognized core deposit intangibles of \$209 million and other intangibles of \$149 million at acquisition. In connection with the May 1, 2012 acquisition of the HSBC credit card portfolios, we recognized purchased credit card relationship intangibles of \$2.1 billion and other intangibles of \$82 million at acquisition.

The following table summarizes our intangible assets subject to amortization as of June 30, 2012 and December 31, 2011:

(Dollars in millions)	Carrying Amount of Assets	Accumulated Amortization	June 30, 2012 Currency valuation Adjustments	Net Carrying Amount	Remaining Amortization Period
Purchased credit card relationship intangibles <sup>(1)</sup>	\$ 2,209	\$ (119)	\$ 0	\$ 2,090	8.2 years
Core deposit intangibles <sup>(2)</sup>	1,771	(1,180)	0	591	6.1 years
Other <sup>(3)</sup>	389	(108)	(1)	280	10.2 years
Total	\$ 4,369	\$ (1,407)	\$ (1)	\$ 2,961	

(Dollars in millions)	Carrying Amount of Assets	Accumulated Amortization	December 31, 2011 Currency valuation Adjustments	Net Carrying Amount	Remaining Amortization Period
Purchased credit card relationship intangibles	\$ 77	\$ (25)	\$ 0	\$ 52	5.3 years
Core deposit intangibles	1,562	(1,083)	0	479	6.3 years
Other	160	(80)	(1)	79	11.7 years
Total	\$ 1,799	\$ (1,188)	\$ (1)	\$ 610	



Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

- (1) Includes purchased credit card relationship intangibles with a net carrying value of \$2.0 billion related to the HSBC U.S. Card acquisition.
- (2) Includes core deposit intangibles with a net carrying value of \$187 million related to the acquisition of ING Direct in the first quarter of 2012.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(3) Includes brokerage relations intangibles with a net carrying value of \$79 million, partnership contract intangibles with a net carrying value of \$79 million, contract intangibles with a net book value of \$43 million, trade mark/name intangibles with a net carrying value of \$39 million and other intangibles with a net book value of \$40 million.

Intangible assets, which are reported in other assets on our consolidated balance sheets, are amortized over their respective estimated useful lives on an accelerated basis using the sum of the year's digits methodology. Intangible amortization expense, which is included in non-interest expense on our consolidated statements of income, totaled \$157 million and \$57 million for the three months ended June 30, 2012 and 2011, respectively, and \$219 million and \$115 million for the six months ended June 30, 2012 and 2011, respectively. The weighted average amortization period for purchase accounting intangibles is 8.0 years as of June 30, 2012.

The following table summarizes the estimated future amortization expense for intangible assets as of June 30, 2012:

(Dollars in millions)	Estimated Future Amortization Amounts
2012 (remaining six months)	\$ 385
2013	678
2014	551
2015	443
2016	340
Thereafter	564
<b>Total</b>	<b>\$ 2,961</b>

**Mortgage Servicing Rights**

MSRs are recognized at fair value when mortgage loans are sold or securitized in the secondary market and the right to service these loans is retained for a fee. MSR's are recorded at fair value and changes in fair value are recorded as a component of mortgage servicing and other income. We may enter into derivatives to economically hedge changes in fair value of MSR's. We have no other loss exposure on MSR's in excess of the recorded fair value.

We continue to operate the mortgage servicing business and to report the changes in the fair value of MSR's in continuing operations. To evaluate and measure fair value, the underlying loans are stratified based on certain risk characteristics, including loan type, note rate and investor servicing requirements.

The following table sets forth the changes in the fair value of mortgage servicing rights during the three and six months ended June 30, 2012 and June 30, 2011:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Balance at beginning of period	\$ 95	\$ 144	\$ 93	\$ 141
Originations	4	2	8	6
Change in fair value, net	(15)	(16)	(17)	(17)
Balance at end of period	\$ 84	\$ 130	\$ 84	\$ 130

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Ratio of mortgage servicing rights to related loans serviced for others	<b>0.53%</b>	0.69%	<b>0.53%</b>	0.71%
Weighted average service fee	<b>0.28bps</b>	0.28bps	<b>0.28bps</b>	0.28bps

122

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

MSR fair value adjustments for the three and six months ended June 30, 2012 included decreases of \$3 million and \$6 million, respectively, due to run-off and cash collections, and a decrease of \$13 million and \$12 million, respectively, due to changes in the valuation inputs and assumptions.

MSR fair value adjustments for the three and six months ended June 30, 2011 included decreases of \$3 million and \$7 million, respectively, due to run-off and cash collections, and decrease of \$13 million and \$10 million, respectively, due to changes in the valuation inputs and assumptions

The significant assumptions used in estimating the fair value of the MSRs as of June 30, 2012 and 2011 were as follows:

	June 30,	
	2012	2011
Weighted average prepayment rate (includes default rate)	<b>18.63%</b>	14.51%
Weighted average life (in years)	<b>5.05</b>	5.99
Discount rate	<b>13.34%</b>	11.74%

The increase in the weighted average prepayment rate and the corresponding decrease in weighted average life were both driven by changes in interest rates.

At June 30, 2012, the sensitivities to immediate 10% and 20% increases in the weighted average prepayment rates would decrease the fair value of mortgage servicing rights by \$4 million and \$8 million, respectively.

At June 30, 2012, the sensitivities to immediate 10% and 20% adverse changes in servicing costs would decrease the fair value of mortgage servicing rights by \$7 million and \$15 million, respectively.

As of June 30, 2012, our mortgage loan servicing portfolio consisted of mortgage loans with an aggregate unpaid principal balance of \$63.2 billion, of which \$16.1 billion was serviced for other investors. As of June 30, 2011, our mortgage loan servicing portfolio consisted of mortgage loans with an aggregate unpaid principal balance of \$28.9 billion, of which \$19.2 billion was serviced for other investors.

**NOTE 9 DEPOSITS AND BORROWINGS****Customer Deposits**

Our customer deposits, which are our largest source of funding for our operations and asset growth, consist of non-interest bearing and interest-bearing deposits, including demand deposits, money market deposits, negotiable order of withdrawal ( NOW ) accounts, savings accounts and certificates of deposit.

As of June 30, 2012, we had \$193.9 billion in interest-bearing deposits of which \$5.0 billion represents large denomination certificates of \$100,000 or more. As of December 31, 2011, we had \$109.9 billion in interest-bearing deposits, of which \$4.6 billion represents large denomination certificates of \$100,000 or more.

**Borrowings**

We also access the capital markets to meet our funding needs through loan securitization transactions and the issuance of senior and subordinated debt. As of June 30, 2012, we had an effective shelf registration statement filed with the U.S. Securities & Exchange Commission ( SEC ) under which, from time to time, we may offer

---

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

and sell an indeterminate aggregate amount of senior or subordinated debt securities, preferred stock, depository shares, common stock, purchase contracts, warrants, and units. There is no limit under this shelf registration statement to the amount or number of such securities that we may offer and sell. We filed a new effective shelf registration statement with the SEC on April 30, 2012. Under SEC rules, the shelf registration statement expires three years after filing.

In addition to issuance capacity under the shelf registration statement, we have access to other borrowing programs, including advances from the FHLB. Our FHLB membership is secured by our investment in FHLB stock, which totaled \$686 million and \$362 million, as of June 30, 2012 and December 31, 2011, respectively.

*Securitized Debt Obligations*

We had \$13.6 billion and \$16.5 billion of securitized debt obligations as of June 30, 2012 and December 31, 2011, respectively, all of which were held by third party investors.

*Senior and Subordinated Debt*

As of June 30, 2012, we had \$12.1 billion of senior and subordinated notes outstanding, which included \$900 million in fair value hedging losses. As of December 31, 2011, we had \$11.0 billion of senior and subordinated notes outstanding, including \$823 million in fair value hedging losses. One senior note for \$282 million matured during the six months ended June 30, 2012. During the first six months of 2012, we issued senior notes in the total amount of \$1.25 billion. The new senior notes are due in 2015.

See Note 10 Derivative Instruments and Hedging Activities for information about our fair value hedging activities.

Under a Senior and Subordinated Global Bank Note Program, COBNA has issued debt securities to both U.S. and non-U.S. lenders and raised funds in U.S. and foreign currencies. The Senior and Subordinated Global Bank Note Program had \$802 million and \$810 million outstanding at June 30, 2012 and December 31, 2011, respectively.

*Junior Subordinated Debentures*

We had \$3.6 billion of outstanding junior subordinated debentures as of both June 30, 2012 and December 31, 2011. There were no junior subordinated borrowings that were called or matured during the six months ended June 30, 2012.

*FHLB Advances*

We had outstanding FHLB advances, which are secured by our investment securities, residential home loan portfolio, multifamily loans, commercial real-estate loans and home equity lines of credit, totaling \$5.4 billion and \$6.9 billion as of June 30, 2012 and December 31, 2011, respectively.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Composition of Customer Deposits, Short-term Borrowings and Long-term Debt**

The table below summarizes the components of our deposits, short-term borrowings and long-term debt as of June 30, 2012 and December 31, 2011. Our total short-term borrowings consist of federal funds purchased and securities loaned under agreements to repurchase and other short-term borrowings with an original contractual maturity of one year or less. Our long-term debt consists of borrowings with an original contractual maturity of greater than one year. The amounts presented for outstanding borrowings include unamortized debt premiums and discounts, net of fair value hedge accounting adjustments.

(Dollars in millions)	June 30, 2012	December 31, 2011			
<b>Deposits:</b>					
Non-interest bearing deposits	\$ 20,072	\$ 18,281			
Interest-bearing deposits	193,859	109,945			
Total deposits	\$ 213,931	\$ 128,226			
<b>Short-term borrowings:</b>					
Federal Funds purchased and securities loaned or sold under agreements to repurchase	\$ 1,101	\$ 1,464			
FHLB Advances	4,400	5,835			
Total short-term borrowings	\$ 5,501	\$ 7,299			
	June 30, 2012	December 31, 2011			
(Dollars in millions)	Maturity Date	Interest Rate	Weighted Average Interest Rate		
<b>Long-term debt:</b>					
Securitized debt obligations	2012 - 2025	0.27% - 6.40%	1.76%	\$ 13,608	\$ 16,527
Senior and subordinated notes:					
Fixed unsecured senior debt	2013 - 2021	2.13% - 7.38%	4.72%	7,887	6,850
Floating unsecured senior debt	2014	1.62%	1.62%	250	250
Total unsecured senior debt			4.62%	8,137	7,100
Fixed unsecured subordinated debt	2012 - 2019	5.35% - 8.80%	7.30%	3,942	3,934
Total senior and subordinated notes				12,079	11,034
Other long-term borrowings:					
Fixed junior subordinated debt	2027 - 2066	3.63% - 10.25%	8.60%	3,642	3,642
FHLB advances	2012 - 2023	0.54% - 6.88%	0.41%	1,044	1,059
Total other long-term borrowings				4,686	4,701
Total long-term debt				\$ 30,373	\$ 32,262
Total short-term borrowings and long-term debt				\$ 35,874	\$ 39,561





**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Components of Interest Expense**

The following table displays interest expense attributable to short-term borrowings and long-term debt for the three and six months ended June 30, 2012 and 2011:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Short-term borrowings:</b>				
Federal funds purchased and securities loaned or sold under agreements to repurchase	\$ 0	\$ 2	\$ 1	\$ 3
FHLB advances	3	1	4	1
Total short-term borrowings	3	3	5	4
<b>Long-term debt:</b>				
Securitized debt obligations	69	113	149	253
Senior and subordinated notes:				
Unsecured senior debt	56	34	114	69
Unsecured subordinated debt	31	29	61	58
Total senior and subordinated notes	87	63	175	127
Other long-term borrowings:				
Junior subordinated debt	78	72	157	152
FHLB advances	3	3	6	6
Other	2	2	4	4
Total long-term debt	239	253	491	542
Total short-term borrowings and long-term debt	\$ 242	\$ 256	\$ 496	\$ 546

**NOTE 10 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES****Use of Derivatives**

We manage our asset/liability position and market risk exposure in accordance with prescribed risk management policies and limits established by our Asset Liability Management Committee and approved by our Board of Directors. Our primary market risk stems from the impact on our earnings and economic value of equity from changes in interest rates, and to a lesser extent, changes in foreign exchange rates. We manage our interest rate sensitivity through several approaches, which include, but are not limited to, changing the maturity and re-pricing characteristics of

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

various balance sheet categories and by entering into interest rate derivatives. Derivatives are also utilized to manage our exposure to changes in foreign exchange rates. Derivative instruments may be privately negotiated contracts, which are often referred to as over-the-counter ( OTC ) derivatives, or they may be listed and traded on an exchange. We execute our derivative contracts in both the OTC and exchange-traded derivative markets. In addition to interest rate swaps, we use a variety of other derivative instruments, including caps, floors, options, futures and forward contracts, to manage our interest rate and foreign currency risk. On a regular basis, we enter into customer-accommodation derivative transactions. We engage in these transactions as a service to our commercial banking customers to facilitate their risk management objectives. We typically offset the market risk exposure to our customer-accommodation derivatives through derivative transactions with other counterparties.

---

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Accounting for Derivatives**

We account for derivatives pursuant to the accounting standards for derivatives and hedging. The outstanding notional amount of our derivative contracts totaled \$55.3 billion as of June 30, 2012, compared with \$73.2 billion as of December 31, 2011, primarily due to the termination of the ING Direct acquisition hedges. The notional amount provides an indication of the volume of our derivatives activity and is used as the basis on which interest and other payments are determined; however, it is generally not the amount exchanged. Derivatives are recorded at fair value in our consolidated balance sheets. The fair value of a derivative represents our estimate of the amount at which a derivative could be exchanged in an orderly transaction between market participants. We report derivatives in a gain position, or derivative assets, in our consolidated balance sheets as a component of other assets. We report derivatives in a loss position, or derivative liabilities, in our consolidated balance sheets as a component of other liabilities. We report derivative asset and liability amounts on a gross basis based on individual contracts, which does not take into consideration the effects of master counterparty netting agreements or collateral netting. The fair value of derivative assets and derivative liabilities reported in our consolidated balance sheets was \$1.9 billion and \$442 million, respectively, as of June 30, 2012, compared with \$1.9 billion and \$987 million, respectively, as of December 31, 2011.

Our derivatives are designated as either qualifying accounting hedges or free-standing derivatives. Free-standing derivatives consist of customer-accommodation derivatives and economic hedges that we enter into for risk management purposes that are not linked to specific assets or liabilities or to forecasted transactions and, therefore, do not qualify for hedge accounting. Qualifying accounting hedges are designated as fair value hedges, cash flow hedges or net investment hedges.

**Fair Value Hedges:** We designate derivatives as fair value hedges to manage our exposure to changes in the fair value of certain financial assets and liabilities, which fluctuate in value as a result of movements in interest rates. Changes in the fair value of derivatives designated as fair value hedges are recorded in earnings together with offsetting changes in the fair value of the hedged item and any resulting ineffectiveness. Our fair value hedges consist of interest rate swaps that are intended to modify our exposure to interest rate risk on various fixed rate senior notes, subordinated notes, securitization debt, brokered certificates of deposits and U.S. agency investments. These hedges have maturities through 2021 and have the effect of converting some of our fixed rate debt, deposits and investments to variable rate.

**Cash Flow Hedges:** We designate derivatives as cash flow hedges to manage our exposure to variability in cash flows related to forecasted transactions. Changes in the fair value of derivatives designated as cash flow hedges are recorded as a component of AOCI, to the extent that the hedge relationships are effective, and amounts are reclassified from AOCI to earnings as the forecasted transactions occur. To the extent that any ineffectiveness exists in the hedge relationships, the amounts are recorded in current period earnings. Our cash flow hedges consist of interest rate swaps that are intended to hedge the variability in interest payments on some of our variable rate debt issuances and assets through 2017. These hedges have the effect of converting some of our variable rate debt and assets to a fixed rate. We also have entered into forward foreign currency derivative contracts to hedge our exposure to variability in cash flows related to foreign currency denominated debt.

**Net Investment Hedges:** We use net investment hedges, primarily forward foreign exchange contracts, to manage the exposure related to our net investments in consolidated foreign operations that have functional currencies other than the U.S. dollar. Changes in the fair value of net investment hedges are recorded in the translation adjustment component of AOCI. During the third quarter of 2011, we discontinued hedge accounting on our only net investment hedge. Therefore, we did not have any net investment hedges outstanding as of June 30, 2012.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Free-Standing Derivatives:** We use free-standing derivatives, or economic hedges, to hedge the risk of changes in the fair value of residential MSRs, mortgage loan origination and purchase commitments and other interests held. We also categorize our customer-accommodation derivatives and the related offsetting contracts as free-standing derivatives. Changes in the fair value of free-standing derivatives are recorded in earnings as a component of other non-interest income.

**Balance Sheet Presentation**

The following table summarizes the fair value and related outstanding notional amounts of derivative instruments reported in our consolidated balance sheets as of June 30, 2012 and December 31, 2011. The fair value amounts are segregated by derivatives that are designated as accounting hedges and those that are not, and are further segregated by type of contract within those two categories.

(Dollars in millions)	Notional or Contractual Amount	June 30, 2012 Derivatives at Fair Value		Notional or Contractual Amount	December 31, 2011 Derivatives at Fair Value	
		Assets <sup>(1)</sup>	Liabilities <sup>(1)</sup>		Assets <sup>(1)</sup>	Liabilities <sup>(1)</sup>
<b>Derivatives designated as accounting hedges:</b>						
Interest rate contracts:						
Fair value interest rate contracts	\$ 16,858	\$ 1,097	\$ 0	\$ 14,425	\$ 1,019	\$ 1
Cash flow interest rate contracts	9,025	47	0	6,325	71	130
Total interest rate contracts	25,883	1,144	0	20,750	1,090	131
Foreign exchange contracts:						
Cash flow foreign exchange contracts	5,127	63	14	4,577	93	16
Net investment foreign exchange contracts	0	0	0	0	0	0
Total foreign exchange contracts	5,127	63	14	4,577	93	16
Total derivatives designated as accounting hedges	31,010	1,207	14	25,327	1,183	147
<b>Derivatives not designated as accounting hedges:<sup>(1)</sup></b>						
Interest rate contracts covering:						
MSRs	292	21	9	383	18	12
Customer accommodation <sup>(2)</sup>	18,036	502	328	16,147	453	395
Other interest rate exposures	3,630	49	25	29,027	85	362
Total interest rate contracts	21,958	572	362	45,557	556	769
Foreign exchange contracts	1,327	147	59	1,348	193	65
Other contracts	1,028	3	7	932	4	6
Total derivatives not designated as accounting hedges	24,313	722	428	47,837	753	840
Total derivatives	\$ 55,323	\$ 1,929	\$ 442	\$ 73,164	\$ 1,936	\$ 987



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

- (1) Derivative asset and liability amounts are presented on a gross basis based on individual contracts and do not reflect the impact of legally enforceable master counterparty netting agreements, collateral received/posted or net credit risk valuation adjustments. We recorded a net cumulative credit risk valuation adjustment related to our derivative positions of \$16 million and \$23 million as of June 30, 2012 and December 31, 2011, respectively. See *Derivative Counterparty Credit Risk* below for additional information.
- (2) Customer accommodation derivatives include those entered into with our commercial banking customers and those entered into with other counterparties to offset the market risk.

Upon the completion of the ING Direct acquisition in February 2012, we terminated the portfolio of interest-rate swaps we entered into in anticipation of the acquisition. These interest-rate swaps consisted of an initial notional amount of \$23.8 billion and an additional notional amount of \$1.0 billion resulting from subsequent rebalancing actions. The total cash payment at termination was \$355 million. We recognized a mark-to-market loss of \$78 million in earnings in the first quarter of 2012 related to these swaps.

**Income Statement Presentation and AOCI**

The following tables summarize the impact of derivatives and related hedged items on our consolidated statements of income and AOCI.

***Fair Value Hedges and Free-Standing Derivatives***

The net gains (losses) recognized in earnings related to derivatives in fair value hedging relationships and free-standing derivatives are presented below for the three and six months ended June 30, 2012 and 2011:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Derivatives designated as accounting hedges:</b>				
Fair value interest rate contracts:				
Loss recognized in earnings on derivatives <sup>(1)</sup>	\$ 147	\$ 190	\$ 79	\$ 41
Gain recognized in earnings on hedged items <sup>(1)</sup>	(146)	(192)	(87)	(37)
Net fair value hedge ineffectiveness gain (loss)	1	(2)	(8)	4
<b>Derivatives not designated as accounting hedges:</b>				
Interest rate contracts covering:				
MSRs <sup>(1)</sup>	5	(3)	3	(4)
Customer accommodation <sup>(1)</sup>	7	3	18	10
Other interest rate exposures <sup>(1)</sup>	24	0	(57)	6
Total	36	0	(36)	12
Foreign exchange contracts <sup>(1)</sup>	4	1	(9)	(2)
Other contracts <sup>(1)</sup>	(2)	12	(3)	9
Total gain (loss) on derivatives not designated as accounting hedges	38	13	(48)	19
Net derivatives gain (loss) recognized in earnings	\$ 39	\$ 11	\$ (56)	\$ 23

(1) Amounts are recorded in our consolidated statements of income in other non-interest income.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Cash Flow and Net Investment Hedges**

The table below shows the net gains (losses) related to derivatives designated as cash flow hedges and net investment hedges for the three and six months ended June 30, 2012 and 2011:

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Gain (loss) recorded in AOCI:<sup>(1)</sup></b>				
<b>Cash flow hedges:</b>				
Interest rate contracts	\$ 50	\$ 15	\$ 56	\$ 22
Foreign exchange contracts	(5)	(10)	(11)	(10)
Subtotal	45	5	45	12
<b>Net investment hedges:</b>				
Foreign exchange contracts	0	0	0	(1)
Net derivatives gain recognized in AOCI	\$ 45	\$ 5	\$ 45	\$ 11
<b>Gain (loss) recorded in earnings:</b>				
<b>Cash flow hedges:</b>				
Gain (loss) reclassified from AOCI into earnings:				
Interest rate contracts <sup>(2)</sup>	\$ 11	\$ 14	\$ 20	\$ 2
Foreign exchange contracts <sup>(3)</sup>	(5)	(7)	(11)	(9)
Subtotal	6	7	9	(7)
Gain (loss) recognized in earnings due to ineffectiveness:				
Interest rate contracts <sup>(3)</sup>	0	0	0	0
Foreign exchange contracts <sup>(3)</sup>	0	0	0	0
Subtotal	0	0	0	0
Net derivatives gain (loss) recognized in earnings	\$ 6	\$ 7	\$ 9	\$ (7)

<sup>(1)</sup> Amounts represent the effective portion.

<sup>(2)</sup> Amounts reclassified are recorded in our consolidated statements of income in interest income or interest expense.

<sup>(3)</sup> Amounts reclassified are recorded in our consolidated statements of income in other non-interest income.

We expect to reclassify net after-tax gains of \$33 million recorded in AOCI as of June 30, 2012, related to derivatives designated as cash flow hedges to earnings over the next 12 months, which we expect to offset against the cash flows associated with the hedged forecasted transactions. The maximum length of time over which forecasted transactions were hedged was five years as of June 30, 2012. The amount we expect to reclassify into earnings may change as a result of changes in market conditions and ongoing actions taken as part of our overall risk management strategy.



**Credit Default Swaps**

We have credit exposure on credit default swap agreements that we entered into to manage our risk of loss on certain manufactured housing securitizations issued by GreenPoint Credit LLC in 2000. Our maximum credit exposure related to these swap agreements totaled \$21 million and \$23 million as of June 30, 2012 and December 31, 2011, respectively.

---

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

These agreements are recorded in our consolidated balance sheets as a component of other liabilities. The value of our obligations under these swaps was \$13 million and \$12 million as of June 30, 2012 and December 31, 2011, respectively. See Note 7 Variable Interest Entities and Securitizations for additional information about our manufactured housing securitization transactions.

**Credit Risk-Related Contingency Features**

Certain of our derivative contracts include provisions requiring that our debt maintain a credit rating of investment grade or above by each of the major credit rating agencies. In the event of a downgrade of our debt credit rating below investment grade, some of our derivative counterparties would have the right to terminate the derivative contract and close-out the existing positions. Other derivative contracts include provisions that would, in the event of a downgrade of our debt credit rating below investment grade, allow our derivative counterparties to demand immediate and ongoing full overnight collateralization on derivative instruments in a net liability position. Certain of our derivative contracts may allow, in the event of a downgrade of our debt credit rating of any kind, our derivative counterparties to demand additional collateralization on such derivative instruments in a net liability position. The fair value of derivative instruments with credit-risk-related contingent features in a net liability position was \$40 million and \$141 million as of June 30, 2012 and December 31, 2011, respectively. We were required to post collateral, consisting of a combination of cash and securities, totaling \$225 million and \$353 million as of June 30, 2012 and December 31, 2011, respectively. If our debt credit rating had fallen below investment grade, we would have been required to post additional collateral of \$22 million and \$39 million as of June 30, 2012 and December 31, 2011, respectively.

**Derivative Counterparty Credit Risk**

Derivative instruments contain an element of credit risk that arises from the potential failure of a counterparty to perform according to the contractual terms of the contract. Our exposure to derivative counterparty credit risk at any point in time is represented by the fair value of derivatives in a gain position, or derivative assets, assuming no recoveries of underlying collateral. To mitigate the risk of counterparty default, we maintain collateral agreements with certain derivative counterparties. These agreements typically require both parties to maintain collateral in the event the fair values of derivative financial instruments exceed established thresholds. We received cash collateral from derivatives counterparties totaling \$1.1 billion and \$894 million as of June 30, 2012 and December 31, 2011, respectively. We also received securities from derivatives counterparties totaling \$251 million as of June 30, 2012, which we have the ability to repledge. We posted cash collateral in accounts maintained by derivatives counterparties totaling \$225 million and \$353 million as of June 30, 2012 and December 31, 2011, respectively.

We record counterparty credit risk valuation adjustments on our derivative assets to properly reflect the credit quality of the counterparty. We consider collateral and legally enforceable master netting agreements that mitigate our credit exposure to each counterparty in determining the counterparty credit risk valuation adjustment, which may be adjusted in future periods due to changes in the fair value of the derivative contract, collateral and creditworthiness of the counterparty. The cumulative counterparty credit risk valuation adjustment recorded on our consolidated balance sheets as a reduction in the derivative asset balance was \$17 million and \$25 million as of June 30, 2012 and December 31, 2011, respectively. We also adjust the fair value of our derivative liabilities to reflect the impact of our credit quality. We calculate this adjustment by comparing the spreads on our credit default swaps to the discount benchmark curve. The cumulative credit risk valuation adjustment related to our credit quality recorded on our consolidated balance sheets as a reduction in the derivative liability balance was \$1 million and \$2 million as of June 30, 2012 and December 31, 2011, respectively.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****NOTE 11 STOCKHOLDERS EQUITY****Accumulated Other Comprehensive Income ( AOCI )**

The following table presents the cumulative balances of accumulated other comprehensive income, net of deferred tax of \$245 million and \$142 million as of June 30, 2012 and December 31, 2011, respectively:

(Dollars in millions)	June 30, 2012	December 31, 2011
Net unrealized gains on securities <sup>(1)</sup>	\$ 393	\$ 294
Net unrecognized elements of defined benefit plans	(46)	(43)
Foreign currency translation adjustments	(38)	(49)
Unrealized gains (losses) on cash flow hedging instruments	14	(26)
Other-than-temporary impairment not recognized in earnings on securities	44	10
Initial application of measurement date provisions for postretirement benefits other than pensions	(1)	(1)
Initial application from adoption of consolidation standards	(16)	(16)
Total accumulated other comprehensive income	\$ 350	\$ 169

<sup>(1)</sup> Includes net unrealized gains (losses) on securities available for sale and retained subordinated notes. Unrealized losses not related to credit on other-than-temporarily impaired securities of \$116 million (net of income tax of \$74 million) and \$170 million (net of income tax of \$109 million) were reported in other comprehensive income as of June 30, 2012 and December 31, 2011, respectively.

**NOTE 12 EARNINGS PER COMMON SHARE**

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

(Dollars and Shares in millions, except per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Basic earnings per share</b>				
Income from continuing operations, net of tax	\$ 193	\$ 945	\$ 1,698	\$ 1,977

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Loss from discontinued operations, net of tax	<b>(100)</b>	(34)	<b>(202)</b>	(50)
Net income applicable to common equity	<b>93</b>	911	<b>1,496</b>	1,927
Dividends and undistributed earnings allocated to participating securities <sup>(1)</sup>	<b>(1)</b>	0	<b>(8)</b>	0
Net income available to common stockholders	<b>\$ 92</b>	\$ 911	<b>\$ 1,488</b>	\$ 1,927
Total weighted-average basic shares outstanding	<b>578</b>	456	<b>543</b>	455
Net income per share	<b>\$ 0.16</b>	\$ 2.00	<b>\$ 2.74</b>	\$ 4.24

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars and Shares in millions, except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
<b>Diluted earnings per share<sup>(2)</sup></b>				
Net income available to common stockholders	\$ 92	\$ 911	\$ 1,488	\$ 1,927
Total weighted-average basic shares outstanding	578	456	543	455
Stock options, warrants, contingently issuable shares, and other	5	6	5	6
Total weighted-average diluted shares outstanding	583	462	548	461
Net income per share	\$ 0.16	\$ 1.97	\$ 2.72	\$ 4.18

<sup>(1)</sup> Includes undistributed earnings allocated to participating securities using the two-class method under the accounting guidance for computing earnings per share.

<sup>(2)</sup> Excluded from the computation of diluted earnings per share was 7 million and 8 million of awards, options or warrants for the three months ended June 30, 2012 and 2011, respectively, and 8 million and 9 million of awards, options or warrants for the six months ended June 30, 2012 and 2011, respectively, because their inclusion would be anti-dilutive.

On February 16, 2012, we settled forward sale agreements that we entered into with certain counterparties acting as forward purchasers in connection with a public offering of shares of our common stock on July 19, 2011. Pursuant to the forward sale agreements, we issued 40 million shares of our common stock at settlement.

On February 17, 2012, as part of the consideration for the acquisition of ING Direct, we issued 54,028,086 shares of our common stock to the ING Sellers.

On March 20, 2012 we closed a public offering of 24,442,706 shares of our common stock which we sold to the underwriters at a per share price of \$51.14 for net proceeds of approximately \$1.25 billion.

**NOTE 13 FAIR VALUE OF FINANCIAL INSTRUMENTS**

Fair value is defined as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date (also referred to as an exit price). The fair value accounting guidance provides a three-level fair value hierarchy for classifying financial instruments. This hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Fair value measurement of a financial asset or liability is assigned to a level based on the lowest level of any input that is significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are described below:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Level 2: Observable market-based inputs, other than quoted prices in active markets for identical assets or liabilities.

Level 3: Unobservable inputs.

The accounting guidance for fair value requires that we maximize the use of observable inputs and minimize the use of unobservable inputs in determining fair value. Accounting guidance provides for the irrevocable option to elect, on a contract-by-contract basis, to measure certain financial assets and liabilities at fair value at inception of the contract and record any subsequent changes in fair value into earnings. We had not made any material fair value option elections as of June 30, 2012 and December 31, 2011.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Level 1, 2 and 3 Valuation Techniques**

Financial instruments are considered Level 1 when the valuation can be based on quoted prices in active markets for identical assets or liabilities. Level 2 financial instruments are valued using quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or models using inputs that are observable or can be corroborated by observable market data of substantially the full term of the assets or liabilities. 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 and when determination of the fair value requires significant management judgment or estimation.

The following table displays our assets and liabilities measured on our consolidated balance sheets at fair value on a recurring basis as of June 30, 2012 and December 31, 2011:

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

(Dollars in millions)	June 30, 2012			Total
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Securities available for sale:				
U.S. Treasury debt obligations	\$ 1,562	\$ 0	\$ 0	\$ 1,562
U.S. Agency debt obligations	0	324	64	388
Residential mortgage-backed securities	0	33,117	1,170	34,287
Commercial mortgage-backed securities	0	5,842	267	6,109
Asset-backed securities	0	11,396	293	11,689
Other	283	961	10	1,254
<b>Total securities available for sale</b>	<b>1,845</b>	<b>51,640</b>	<b>1,804</b>	<b>55,289</b>
Other assets:				
Mortgage servicing rights	0	0	84	84
Derivative receivables <sup>(1)(2)</sup>	3	1,823	103	1,929
Retained interests in securitizations and other	0	0	140	140
<b>Total assets</b>	<b>\$ 1,848</b>	<b>\$ 53,463</b>	<b>\$ 2,131</b>	<b>\$ 57,442</b>
<b>Liabilities</b>				
Other liabilities:				
Derivative payables <sup>(1)(2)</sup>	\$ (4)	\$ (404)	\$ (34)	\$ (442)
Other <sup>(3)</sup>	0	0	(13)	(13)
<b>Total liabilities</b>	<b>\$ (4)</b>	<b>\$ (404)</b>	<b>\$ (47)</b>	<b>\$ (455)</b>

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	December 31, 2011			Total
	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Securities available for sale:				
U.S. Treasury debt obligations	\$ 124	\$ 0	\$ 0	\$ 124
U.S. Agency debt obligations	0	138	0	138
Residential mortgage-backed securities	0	26,455	195	26,650
Commercial mortgage-backed securities	0	913	274	1,187
Asset-backed securities	0	10,118	32	10,150
Other	279	219	12	510
<b>Total securities available for sale</b>	<b>403</b>	<b>37,843</b>	<b>513</b>	<b>38,759</b>
Other assets:				
Mortgage servicing rights	0	0	93	93
Derivative receivables <sup>(1)(2)</sup>	5	1,828	103	1,936
Retained interests in securitizations and other	0	0	145	145
<b>Total assets</b>	<b>\$ 408</b>	<b>\$ 39,671</b>	<b>\$ 854</b>	<b>\$ 40,933</b>
<b>Liabilities</b>				
Other liabilities:				
Derivative payables <sup>(1)(2)</sup>	\$ (6)	\$ (702)	\$ (279)	\$ (987)
Other <sup>(3)</sup>	0	0	(12)	(12)
<b>Total liabilities</b>	<b>\$ (6)</b>	<b>\$ (702)</b>	<b>\$ (291)</b>	<b>\$ (999)</b>

(1) We do not offset the fair value of derivative contracts in a loss position against the fair value of contracts in a gain position. We also do 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.

(2) Does not reflect \$16 million and \$23 million recognized as a net valuation allowance on derivative assets and liabilities for non-performance risk as of June 30, 2012 and December 31, 2011, respectively. Non-performance risk is reflected in other assets/liabilities on the balance sheet and offset through the income statement in other income.

(3) Includes manufactured housing, swap and other transactions. See Note 7 Variable Interest Entities and Securitizations for additional information.

The determination of the classification of financial instruments in Level 2 or Level 3 of the fair value hierarchy is performed at the end of each reporting period. We consider all available information, including observable market data, indications of market liquidity and orderliness, and our understanding of the valuation techniques and significant inputs. Based upon the specific facts and circumstances of each instrument or instrument category, judgments are made regarding the significance of the Level 3 inputs to the instruments' fair value measurement in its entirety. If Level 3 inputs are considered significant, the instrument is classified as Level 3. The process for determining fair value using unobservable inputs is generally more subjective and involves a high degree of management judgment and assumptions. During the second quarter and first six months of 2012, we had minimal movements between Levels 1 and 2.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Level 3 Instruments Only**

Financial instruments are considered Level 3 when their values are determined using pricing models, which include comparison of prices from multiple sources, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable or there is significant variability among pricing sources. Level 3 financial instruments also include those for which the determination of fair value requires significant management judgment or estimation. The tables below present reconciliation for all assets and liabilities measured and recognized at fair value on a recurring basis using significant unobservable inputs (Level 3). When assets and liabilities are transferred between levels, we recognize the transfer as of the end of the period.

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**  
**Three Months Ended June 30, 2012**

(Dollars in millions)	Balance, March 31, 2012	Total Gains or (Losses) (Realized/Unrealized) Included in Net Income (1)	Included in Other Comprehensive Income	Purchases	Sales	Issuances	Settlements	Transfers Into Level 3(2)	Transfers Out of Level 3(2)	Balance, June 30, 2012	Net Unrealized Gains (Losses) Included in Net Income Related to Assets and Liabilities Still Held as of June 30, 2012(3)
<b>Assets:</b>											
Securities available -for-sale:											
U.S. Agency Debt Obligations	\$ 0	\$ 0	\$ 1	\$ 50	\$ 0	\$ 0	\$ (1)	\$ 14	\$ 0	\$ 64	\$ 0
Residential mortgage-backed securities	1,821	9	13	4	0	0	(134)	130	(673)	1,170	9
Commercial mortgage-backed securities	387	0	8	173	0	0	(16)	0	(285)	267	0
Asset-backed securities	241	0	8	50	0	0	(1)	0	(5)	293	0
Other	7	0	0	0	0	0	0	3	0	10	0
Total securities available -for-sale	2,456	9	30	277	0	0	(152)	147	(963)	1,804	9
<b>Other Assets:</b>											
Mortgage servicing rights	95	(12)	0	0	0	4	(3)	0	0	84	(12)
Derivative receivables	65	47	0	0	0	3	(12)	0	0	103	47
Retained interest in securitization and other	140	0	0	0	0	0	0	0	0	140	0
<b>Liabilities:</b>											
Other Liabilities											
Derivative Payables	(36)	(8)	0	0	0	0	10	0	0	(34)	(8)
Other	(14)	1	0	0	0	0	0	0	0	(13)	1



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Fair Value Measurements Using Significant Unobservable Inputs (Level 3)  
Three Months Ended June 30, 2011**

(Dollars in millions)	Balance, March 31, 2011	Total Gains or (Losses) (Realized/Unrealized) Included		Purchases	Sales	Issuances	Settlements	Transfers Into Level 3 <sup>(2)</sup>	Transfers Out of Level 3 <sup>(2)</sup>	Balance, June 30, 2011	Net Unrealized Gains (Losses) Included in Net Income Related to Assets and Liabilities Still Held as of June 30, 2011 <sup>(3)</sup>
		in Net Income <sup>(1)</sup>	Other Comprehensive Income								
<b>Assets:</b>											
Securities available-for-sale:											
Residential											
mortgage-backed securities	\$ 519	\$ 0	\$ 3	\$ 34	\$ 0	\$ 0	\$ (22)	\$ 26	\$ (203)	\$ 357	\$ 0
Asset-backed securities	13	0	(1)	0	0	0	0	0	(3)	9	0
Other	7	0	0	0	0	0	0	5	0	12	0
Total securities available -for-sale	539	0	2	34	0	0	(22)	31	(206)	378	0
<b>Other Assets:</b>											
Mortgage servicing rights	144	(13)	0	0	0	2	(3)	0	0	130	(13)
Derivative receivables	41	9	0	0	0	2	(7)	0	(1)	44	9
Retained interest in securitization and other	112	(6)	0	0	0	0	0	0	0	106	(6)
<b>Liabilities:</b>											
Other Liabilities											
Derivative Payables	(39)	(5)	0	0	0	(2)	4	0	0	(42)	(5)

Table of Contents

## CAPITAL ONE FINANCIAL CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)  
Six Months Ended June 30, 2012

(Dollars in millions)	Total Gains or (Losses) (Realized/Unrealized)							Transfers Into Level 3 <sup>(2)</sup>	Transfers Out of Level 3 <sup>(2)</sup>	Balance, June 30, 2012	Net Unrealized Gains (Losses) Included in Net Income Related to Assets and Liabilities Still Held as of June 30, 2012 <sup>(3)</sup>
	Balance, January 1, 2012	Included in Net Income <sup>(1)</sup>	Included in Other Comprehensive Income	Purchases	Sales	Issuances	Settlements				
<b>Assets:</b>											
Securities available -for-sale:											
U.S. Agency Debt Obligations	\$ 0	\$ 0	\$ 1	\$ 50	\$ 0	\$ 0	\$ (1)	\$ 14	\$ 0	\$ 64	\$ 0
Residential mortgage-backed securities	195	(1)	(13)	2,283	(640)	0	(150)	228	(732)	1,170	(1)
Commercial mortgage-backed securities	274	5	10	470	(76)	0	(19)	13	(410)	267	5
Asset-backed securities	32	0	13	155	0	0	(3)	132	(36)	293	0
Other	12	0	0	0	0	0	(5)	9	(6)	10	0
Total securities available -for-sale	513	4	11	2,958	(716)	0	(178)	396	(1,184)	1,804	4
<b>Other Assets:</b>											
Mortgage servicing rights	93	(12)	0	0	0	8	(5)	0	0	84	(12)
Derivative receivables	103	45	0	0	0	4	(61)	13	(1)	103	45
Retained interest in securitization and other	145	(5)	0	0	0	0	0	0	0	140	(5)
<b>Liabilities:</b>											
Other Liabilities											
Derivative Payables	(279)	(3)	0	0	0	(32)	269	8	3	(34)	(3)
Other	(12)	(1)	0	0	0	0	0	0	0	(13)	(1)

Table of Contents

## CAPITAL ONE FINANCIAL CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Fair Value Measurements Using Significant Unobservable Inputs (Level 3)  
Six Months Ended June 30, 2011

(Dollars in millions)	Balance, January 1, 2011	Total Gains or (Losses) (Realized/Unrealized)		Purchases	Sales	Issuances	Settlements	Transfers Into Level 3 <sup>(2)</sup>	Transfers Out of Level 3 <sup>(2)</sup>	Balance, June 30, 2011	Net Unrealized Gains (Losses) Included in Net Income Related to Assets and Liabilities Still Held as of June 30, 2011 <sup>(3)</sup>
		Included in Net Income <sup>(1)</sup>	Included in Other Comprehensive Income								
<b>Assets:</b>											
Securities available-for-sale:											
Residential											
mortgage-backed securities	\$ 578	\$ 0	\$ (4)	\$ 34	\$ 0	\$ (15)	\$ (59)	\$ 26	\$ (203)	\$ 357	\$ 0
Asset-backed securities	13	0	(1)	0	0	0	0	0	(3)	9	0
Other	7	0	0	0	0	0	0	5	0	12	0
Total securities available-for-sale	598	0	(5)	34	0	(15)	(59)	31	(206)	378	0
<b>Other Assets:</b>											
Mortgage servicing rights	141	(10)	0	0	0	6	(7)	0	0	130	(10)
Derivative receivables	46	11	0	0	0	3	(15)	0	(1)	44	11
Retained interest in securitization and other	117	(11)	0	0	0	0	0	0	0	106	(11)
<b>Liabilities:</b>											
Other Liabilities											
Derivative Payables	(43)	(4)	0	0	0	(2)	7	0	0	(42)	(4)

(1) Gains (losses) related to Level 3 mortgage servicing rights are reported in other non-interest income, which is a component of non-interest income. 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. 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.

(2) The transfers out of Level 3 for the second quarter and first six months of June 30, 2012 and 2011 were primarily driven by greater consistency amongst multiple pricing sources. The transfers into Level 3 was primarily driven by less consistency amongst vendor pricing on individual securities for non-agency MBS.

(3) The amount presented for unrealized gains (loss) for assets still held as of the reporting date primarily represents impairments for available-for-sale securities, accretion on certain fixed maturity securities, and change in fair value of derivative instruments. The impairments are reported in total other-than-temporary losses as a component of non-interest income.

**Significant Level 3 Fair Value Asset and Liability Input Sensitivity**

Changes in unobservable inputs may have a significant impact on fair value. Certain of these unobservable inputs will (in isolation) have a directionally consistent impact on the fair value of the instrument for a given change in that input. Alternatively, the fair value of the instrument may move in an opposite direction for a given change in another input. In general, an increase in the discount rate, default rates, loss severity and credit spreads, in isolation, would result in a



**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

decrease in the fair value measurement. In addition, an increase in default rates would generally be accompanied by a decrease in recovery rates, slower prepayment rates and an increase in liquidity spreads.

**Fair Value Governance and Control**

We have a governance framework and a number of key controls that are intended to ensure that our fair value measurements are appropriate and reliable. Our governance framework provides for independent oversight and segregation of duties. Our control processes include review and approval of new transaction types, price verification and review of valuation judgments, methods, models, process controls and results. Groups independent from our trading and investing functions, including our Valuations Group and Valuations Advisory Committee, participate in the review and validation process.

Our Valuations Group performs periodic independent verification of fair value measurements by using independent analytics and other available market data to determine if assigned fair values are reasonable. For example, in cases where we rely on third party pricing services to obtain fair value measures, we analyze pricing variances among different pricing sources and validate the pricing used by comparing the information to additional sources, including dealer pricing indications in transaction results and other internal sources. Additional validation procedures performed by the Valuations Group include reviewing valuation inputs and assumptions, monitoring limits and acceptable variance thresholds between different pricing sources, and evaluating alternative methodologies and recommend improvements to valuation techniques. We perform due diligence reviews of the third party pricing services, including reviewing their pricing methodology and other control documentation. Additionally, on an on-going basis we may select a sample of securities and test their valuation by obtaining more detailed information about the pricing methodology, sources of information, and assumptions used to value the securities.

The Valuation Advisory Committee delegates the day-to-day valuation oversight to the Fair Value Committee. The Valuation Advisory Committee includes senior representation from business areas, our Enterprise Risk Oversight division and our Finance division. The purpose of the Valuations Advisory Committee is to inform the Chief Financial Officer on the reasonableness of fair valuations and to raise material risks or concerns, if any, concerning fair valuations. The Fair Value Committee regularly reviews and approves our valuation methodologies to ensure that our methodologies and practices are consistent with industry standards and adhere to regulatory and accounting guidance. The Chief Financial Officer determines when material issues or concerns regarding valuations shall be raised to the Audit and Risk Committee or other delegated committee of the Board of Directors.

The following presents the significant unobservable inputs relied upon to determine the fair values of our recurring Level 3 financial instruments. We utilize multiple third party pricing services to obtain fair value measures for our securities. Several of our third party pricing services are only able to provide unobservable input information for a limited number of securities due to software licensing restrictions. Other third party pricing services are able to provide unobservable input information for all securities for which they provide a valuation. As a result, the unobservable input information for the Available for Sale Securities presented below represents a composite summary of all information we are able to obtain for a majority of our securities. The unobservable input information for all other Level 3 financial instruments is based on the assumptions used in our internal valuation models.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Assets and Liabilities Measured at Fair Value on a Recurring Basis**

(Dollars in millions)	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value at June 30, 2012	Significant Valuation Techniques	Significant Unobservable Inputs	Range (Weighted Average)
<b>Assets:</b>				
Securities available-for-sale:				
Residential mortgage-backed securities	1,170	Discounted cash flows (3 <sup>rd</sup> party pricing)	Yield	0-25% (7%) 0-27% (7%)
			Constant prepayment rate	
			Default rate	1-23% (8%)
			Loss severity	4-75% (51%)
Commercial mortgage-backed securities	267	Discounted cash flows (3 <sup>rd</sup> party pricing)	Yield Constant prepayment rate	2-3% (3%) 0-0% (0%)
Asset-backed securities	293	Discounted cash flows (3 <sup>rd</sup> party pricing)	Yield Constant prepayment rate Default rate Loss severity	2-24% (4%) 0-13% (3%) 2-23% (15%) 41-86% (74%)
Other	74	Discounted cash flows	Yield  Constant prepayment rate	N/A  N/A
<b>Other assets:</b>				
Mortgage servicing rights	84	Discounted cash flows	Constant prepayment rate Discount rate Servicing cost (\$ per loan)	9.53-33.59% (18.63%) 9.94-23.00% (13.34%) \$67.17-\$558.00 (\$195.47)
Derivative receivables	103	Discounted cash flows	Swap rates  Constant prepayment rate  Default rate  Loss severity	1.77-2.36% (2.26%)  2.03-3.31% (2.55%)  3.33-4.55% (3.91%)  68.63-85.79% (80.57%)
Retained interests in securitization and other	140	Discounted cash flows	Life of receivables (months)  Constant prepayment rate  Discount rate	26-83 (68) 0.10-16.17% (7.84%)  1.88-42.70% (24.52%)
<b>Liabilities:</b>				



Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Other liabilities:

Derivative payables	<b>(34)</b>	Discounted cash flows	Swap rates	<b>1.77-2.36% (2.26%)</b>
			Black model	Constant prepayment rate
			Default rate	<b>3.33-4.55% (3.91%)</b>
			Loss severity	<b>68.63-85.79% (80.57%)</b>
			Flat volatility	<b>27.63-28.07% (27.69%)</b>
Other (Manufactured housing swap obligations)	<b>(13)</b>	Discounted cash flows	Constant prepayment rate	<b>0.19-0.26% (0.23%)</b>
			Default rate	<b>0.30-0.36% (0.33%)</b>
			Illiquidity risk	<b>1.21</b>

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis**

We are required to measure and recognize certain other financial assets at fair value on a nonrecurring basis in the consolidated balance sheet. These financial assets are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when we evaluate impairment).

***Loans Held For Sale***

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 loans held for sale is determined using a discounted cash flow model or fair value of the underlying collateral, less the estimated cost to sell. Held for sale loans that are valued using a discounted cash flow are classified as Level 2. Loans that are valued using fair value less the estimated cost to sell have significant unobservable inputs and are classified as Level 3 under the fair value hierarchy. Fair value adjustments for loans held for sale are recorded in other non-interest expense in our consolidated statement of income.

***Loans Held For Investment, Net***

Loans held for investment are carried at the fair value of the underlying collateral, less the estimated cost to sell. Due to the use of unobservable inputs, loans held for investment are classified as Level 3 under the fair value hierarchy. Fair value adjustments for loans held for investment are recorded in provision for credit losses in the consolidated statement of income.

***Foreclosed assets***

Foreclosed assets are carried at the lower of its carrying amount or fair value less costs to sell. Due to the use of significant unobservable inputs, foreclosed assets are classified as Level 3 under the fair value hierarchy. Fair value adjustments for foreclosed assets are recorded in other non-interest expense in the consolidated statement of income.

***Other Assets***

Nonrecurring other assets measured at fair value consist of long-lived assets held for sale. These assets are recorded in other assets in our consolidated balance sheets. These assets are carried at the lower of their carrying amount or fair value less costs to sell. Due to the use of unobservable inputs, long-lived assets held for sale are classified as Level 3 under the fair value hierarchy. Fair value adjustments for other assets are recorded in other non-interest expense in the consolidated statement of income.

For assets measured at fair value on a nonrecurring basis and still held on the consolidated balance sheet, the following table provides the fair value measures by level of valuation assumptions used and the gains or losses recognized for these assets as a result of fair value measurements.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	Fair Value Measurements Using			Assets at Fair Value	June 30, 2012 Significant Valuation Techniques	Significant Unobservable Inputs	Range (Weighted Average)
	Level 1	Level 2	Level 3				
Assets							
Loans held for sale	\$ 0	\$ 1,047	\$ 0	\$ 1,047	N/A Appraisal	N/A	N/A 10-38%
Loans held for investment	0	0	61	61	Value Appraisal	Non-recoverable rate Cost to Sell	(14%) 10-14%
Foreclosed assets <sup>(1)</sup>	0	0	65	65	Value Appraisal	Bias Factor	0-11 % 6-6%
Other <sup>(2)</sup>	0	0	23	23	Value	Cost to Sell	(6%)
Total	\$ 0	\$ 1,047	\$ 149	\$ 1,196			

(Dollars in millions)	December 31, 2011 Fair Value Measurements Using			Assets at Fair Value
	Level 1	Level 2	Level 3	
Assets				
Loans held for sale	\$ 0	\$ 201	\$ 0	\$ 201
Loans held for investment	0	0	113	113
Foreclosed assets <sup>(1)</sup>	0	0	169	169
Other <sup>(2)</sup>	0	0	21	21
Total	\$ 0	\$ 201	\$ 303	\$ 504

(Dollars in millions)	Total Gains (Losses) Three Months Ended June 30,	
	2012	2011
Assets		
Loans held for sale	\$ 13	\$ (0)
Loans held for investment	(6)	(28)
Foreclosed assets <sup>(1)</sup>	(6)	(13)
Other <sup>(2)</sup>	(2)	(12)

Total \$ (1) \$ (53)

(Dollars in millions)	Total Gains (Losses)	
	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Assets		
Loans held for sale	\$ 29	\$ (0)
Loans held for investment	(31)	(50)
Foreclosed assets <sup>(1)</sup>	(14)	(24)
Other <sup>(2)</sup>	(4)	(13)
Total	\$ (20)	\$ (87)

(1) Represents the fair value and related losses of foreclosed properties that were written down subsequent to their initial classification as foreclosed properties.

(2) Consists of long lived assets held for sale.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Fair Value of Financial Instruments**

The following reflects the fair value of financial instruments, whether or not recognized on the consolidated balance sheet, at fair value as of June 30, 2012 and December 31, 2011:

(Dollars in millions)	June 30, 2012		Fair Value Measurements Using		
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
<b>Financial assets</b>					
Cash and cash equivalents	\$ 5,979	\$ 5,979	\$ 5,979	\$ 0	\$ 0
Restricted cash for securitization investors	370	370	370	0	0
Securities available for sale	55,289	55,289	1,845	51,640	1,804
Loans held for sale	1,047	1,047	0	1,047	0
Net loans held for investment	197,751	200,141	0	0	200,141
Interest receivable	1,623	1,623	0	1,623	0
Accounts receivable from securitization	96	96	0	0	96
Derivatives	1,929	1,929	3	1,823	103
Mortgage servicing rights	84	84	0	0	84
<b>Financial liabilities</b>					
Non-interest bearing deposits	\$ 20,072	\$ 20,072	\$ 20,072	\$ 0	\$ 0
Interest-bearing deposits	193,859	194,344	0	26,035	168,309
Senior and subordinated notes	12,079	12,328	0	12,328	0
Securitized debt obligations	13,608	13,788	0	11,760	2,028
Federal funds purchased and securities loaned or sold under agreements to repurchase	1,101	1,101	1,101	0	0
Other borrowings	9,086	9,151	351	8,746	54
Interest payable	462	462	0	462	0
Derivatives	442	442	4	404	34

(Dollars in millions)	December 31, 2011	
	Carrying Amount	Estimated Fair Value
<b>Financial assets</b>		
Cash and cash equivalents	\$ 5,838	\$ 5,838
Restricted cash for securitization investors	791	791
Securities available for sale	38,759	38,759
Loans held for sale	201	201
Net loans held for investment	131,642	133,710
Interest receivable	1,029	1,029
Accounts receivable from securitization	94	94
Derivatives	1,936	1,936
Mortgage servicing rights	93	93
<b>Financial liabilities</b>		
Non-interest bearing deposits	\$ 18,281	\$ 18,281
Interest-bearing deposits	109,945	110,002

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Senior and subordinated notes	11,034	10,870
Securitized debt obligations	16,527	16,632
Federal funds purchased and securities loaned or sold under agreements to repurchase	1,464	1,464
Other borrowings	10,536	10,607
Interest payable	466	466
Derivatives	987	987

---

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following describes the valuation techniques used in estimating the fair value of our financial instruments as of June 30, 2012 and December 31, 2011. We applied the fair value provisions, to the financial instruments not recognized on the consolidated balance sheet at fair value, which include loans held for investment, interest receivable, non-interest bearing and interest bearing deposits, other borrowings, senior and subordinated notes, and interest payable. The provisions requiring us to maximize the use of observable inputs and to measure fair value using a notion of exit price were factored into our selection of inputs of our established valuation techniques.

**Financial Assets**

***Cash and Cash Equivalents***

The carrying amounts of cash and due from banks, federal funds sold and resale agreements and interest-bearing deposits at other banks approximate fair value.

***Restricted Cash or Securitization Investors***

The carrying amounts of restricted cash for securitization investors approximate their fair value due to their relatively short-term nature.

***Securities Available For Sale***

Quoted prices in active markets are used to measure the fair value of U.S. Treasury securities. For other investment categories, we utilize multiple third party pricing services to obtain fair value measures for the large majority of our securities. A pricing service may be considered as the primary pricing provider for certain types of securities, and the designation of the primary pricing provider may vary depending on the type of securities. The determination of the primary pricing provider is based on our experience and validation benchmark of the pricing service's performance in terms of providing fair value measurement for the various types of securities.

Certain securities available for sale are classified as Level 2 and 3, the majority of which are collateralized mortgage obligations and mortgage-backed securities. Classification 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. The techniques used by the pricing services utilize observable market data to the extent available. Pricing models may be used, which can vary by asset class and may incorporate available trade, bid and other market information. Across asset classes, information such as trader/dealer input, credit spreads, forward curves, and prepayment speeds are used to help determine appropriate valuations. Because many fixed income securities do not trade on a daily basis, the evaluated pricing applications may apply available information through processes such as benchmarking curves, like securities, sector groupings, and matrix pricing to prepare valuations. In addition, model processes are used by the pricing services to develop prepayment and interest rate scenarios.

We validate the pricing obtained from the primary pricing providers through comparison of pricing to additional sources, including other pricing services, dealer pricing indications in transaction results, and other internal sources. Pricing variances among different pricing sources are analyzed and validated. Additionally, on an on-going basis we may select a sample of securities and test the third party valuation by obtaining more detailed information about the pricing methodology, sources of information, and assumptions used to value the securities.

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The significant unobservable inputs used in the fair value measurement of our residential, asset-backed and commercial securities include yield, prepayment rate, default rate and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation or combination would result in a significant change in fair value measurement. Generally, an increase in the yield assumption will result in a decrease in fair value measurement, however, an increase or decrease in prepayment rate, default rate or loss severity may have a different impact on the fair value given various characteristics of the security including the capital structure of the deal, credit enhancement for the security or other factors.

As of June 30, 2012, we saw further improvements in the market value of our portfolio holdings driven by lower interest rates and reduced risk premiums as compared to 2011. The increase in the amount of Level 3 securities was primarily driven by the increase in non-agency MBS securities due to acquisition of ING Direct securities portfolio.

***Loans Held For Sale***

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 loans held for sale is determined using current secondary market prices for portfolios with similar characteristics. The carrying amounts as of June 30, 2012 and December 31, 2011 approximate fair value.

***Loans Held For Investment, Net***

The fair values of credit card loans, installment loans, auto loans, home loans and commercial loans were estimated using a discounted cash flow method, a form of the income approach. Discount rates were determined considering rates at which similar portfolios of loans would be made under current conditions and considering liquidity spreads applicable to each loan portfolio based on the secondary market. The fair value of credit card loans excluded any value related to customer account relationships. The increase in fair value above carrying amount at June 30, 2012 was primarily due to a tightening of liquidity spreads and improved credit performance noted in our credit card, auto and commercial loan portfolios.

***Interest Receivable***

The carrying amount of interest receivable approximates the fair value of this asset due to its relatively short-term nature.

***Accounts Receivable from Securitizations***

Accounts receivable from securitizations include the interest-only strip, retained notes accrued interest receivable, cash reserve accounts and cash spread accounts for those securitization structures achieving off-balance sheet treatment. Refer to Note 7 Variable Interest Entities and Securitizations for discussion regarding the adoption of the new accounting consolidation standards on January 1, 2010. We use a valuation model that calculates the present value of estimated future cash flows. The model incorporates our estimate of assumptions market participants use in determining fair value, including estimates of payment rates, defaults, and discount rates including adjustments for liquidity, and contractual interest and fees. Other retained interests related to securitizations are carried at cost, which approximates fair value. The valuation technique for these securities is discussed in more detail in Note 7 Variable Interest Entities and Securitizations.



**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

***Derivative Assets***

Most of our derivatives are not exchange traded, but instead traded in over the counter markets where quoted market prices are not readily available. The fair value derived for those derivatives using models that use primarily market observable inputs, such as interest rate yield curves, credit curves, option volatility and currency rates are classified as Level 2. Any derivative fair value measurements using significant assumptions that are unobservable are classified as Level 3, which include interest rate swaps whose remaining terms do not correlate with market observable interest rate yield curves. The impact of counterparty non-performance risk is considered when measuring the fair value of derivative assets. These derivatives are included in other assets on the balance sheet.

We validate the pricing obtained from the internal models through comparison of pricing to additional sources, including external valuation agents and other internal sources. Pricing variances among different pricing sources are analyzed and validated.

***Mortgage Servicing Rights***

MSRs do not trade in an active market with readily observable prices. Accordingly, we determine the fair value of MSR's 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. We record MSR's at fair value on a recurring basis. Fair value measurements of MSR's 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 Goodwill and Other Intangible Assets.

**Financial liabilities**

***Interest Bearing Deposits***

The fair value of other interest-bearing deposits was determined based on discounted expected cash flows using discount rates consistent with current market rates for similar products with similar remaining terms.

***Non-Interest Bearing Deposits***

The carrying amount of non-interest bearing deposits approximates fair value.

***Senior and Subordinated Notes***

We engage multiple third party pricing services in order to estimate the fair value of senior and subordinated notes. The pricing service utilizes a pricing model that incorporates available trade, bid and other market information. It also incorporates spread assumptions, volatility assumptions and relevant credit information into the pricing models.

***Securitized Debt Obligations***

We utilized multiple third party pricing services to obtain fair value measures for the large majority of our securitized debt obligations. The techniques used by the pricing services utilize observable market data to the extent available; and pricing models may be used which incorporate available trade, bid and other market information as described in the above section. We used internal pricing models, discounted cash flow models or similar techniques to estimate the fair value of certain securitization trusts where third party pricing was not available.

---

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

***Other Borrowings***

The carrying amount of federal funds purchased and repurchase agreements, FHLB advances, and other short-term borrowings approximates fair value. The fair value of junior subordinated borrowings was estimated using the same methodology as described for senior and subordinated notes. The fair value of other borrowings was determined based on trade information for bonds with similar duration and credit quality, adjusted to incorporate any relevant credit information of the issuer. The increase in fair value of other borrowings above carrying values at June 30, 2012 was primarily due to interest rate spreads across the industry.

***Interest Payable***

The carrying amount of interest payable approximates the fair value of this liability due to its relatively short-term nature.

***Derivative Liabilities***

Most of our 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, derived using models that use primarily market observable inputs, such as interest rate yield curves, credit curves, option volatility and currency rates, are classified as Level 2. Any derivative fair value measurements using significant assumptions that are unobservable are classified as Level 3, which include interest rate swaps whose remaining terms do not correlate with market observable interest rate yield curves. The impact of counterparty non-performance risk is considered when measuring the fair value of derivative assets. These derivatives are included in other liabilities on the consolidated balance sheets.

We validate the pricing obtained from the internal models through comparison of pricing to additional sources, including external valuation agents and other internal sources. Pricing variances among different pricing sources are analyzed and validated.

***Commitments to extend credit and letters of credit***

These financial instruments are generally not sold or traded. The fair value of the financial guarantees outstanding included in other liabilities as of June 30, 2012 and December 31, 2011 that have been issued since January 1, 2003 was \$5 million and \$4 million, respectively. The estimated fair values of extensions of credit and letters of credit are not readily available. However, the fair value of commitments to extend credit and letters of credit is based on fees currently charged to enter into similar agreements with comparable credit risks and the current creditworthiness of the counterparties. Commitments to extend credit issued by us are generally short-term in nature and, if drawn upon, are issued under current market terms and conditions for credits with comparable risks. At June 30, 2012 and December 31, 2011, there was no material unrealized appreciation or depreciation on these financial instruments.

**NOTE 14 BUSINESS SEGMENTS**

Our principal operations are currently organized into three major business segments, which are defined based on the products and services provided or the type of customer served: Credit Card, Consumer Banking and Commercial Banking. The operations of acquired businesses have been integrated into our existing business segments. Certain activities that are not part of a segment, such as management of our corporate investment portfolio and asset/liability management by our centralized Corporate Treasury group are included in the Other category.



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The results of our individual businesses, which we report on a continuing operations basis, reflect the manner in which management evaluates performance and makes decisions about funding our operations and allocating resources. Our business segment results are intended to reflect each segment as if it were a stand-alone business. We use an internal management and reporting process to derive our business segment results. Our internal management and reporting process employs various allocation methodologies, including funds transfer pricing, to assign certain balance sheet assets, deposits and other liabilities and their related revenue and expenses directly or indirectly attributable to each business segment. Total interest income and net fees are directly attributable to the segment in which they are reported. The net interest income of each segment reflects the results of our funds transfer pricing process, which is primarily based on a matched maturity method that takes into consideration market rates. Our funds transfer pricing process provides a funds credit for sources of funds, such as deposits generated by our Consumer Banking and Commercial Banking businesses, and a funds charge for the use of funds by each segment. The allocation process is unique to each business segment and acquired businesses and considers the interest rate risk, liquidity risk and regulatory requirements of that segment as if it were operating independently.

We may periodically change our business segments or reclassify business segment results based on modifications to our management reporting methodologies and changes in organizational alignment. In the first quarter of 2012, we re-aligned the reporting of our Commercial Banking business to reflect the operations on a product basis rather than by customer type. As a result of this re-alignment, we now report three product categories: commercial and multifamily real estate, commercial and industrial loans and small-ticket commercial real estate, which is a run-off portfolio. We previously reported four categories within our Commercial Banking business: commercial and multifamily real estate, middle market, specialty lending and small-ticket commercial real estate. Middle market and specialty lending related products are included in commercial and industrial loans. All tax-related commercial real estate investments, some of which were previously included in the Other segment, are now included in the commercial and multifamily real estate category of our Commercial Banking business. Prior period amounts have been recast to conform to the current period presentation.

**Segment Results and Reconciliation**

The following tables provide a summary of our business segment results for the three and six months ended June 30, 2012 and 2011 and selected balance sheet data as of June 30, 2012 and December 31, 2011.

(Dollars in millions)	Three Months Ended June 30, 2012				Total
	Credit Card	Consumer Banking	Commercial Banking	Other	
Net interest income (expense)	\$ 2,350	\$ 1,496	\$ 427	\$ (272)	\$ 4,001
Non-interest income (expense)	771	185	82	16	1,054
Total net revenue	3,121	1,681	509	(256)	5,055
Provision for credit losses	1,711	44	(94)	16	1,677
Non-interest expense:					
Core deposit intangible amortization	0	42	9	0	51
Other non-interest expense	1,863	917	242	69	3,091
Total non-interest expense	1,863	959	251	69	3,142
Income from continuing operations before income taxes	(453)	678	352	(341)	236
Income (loss) tax provision (benefit)	(156)	240	124	(165)	43
Income (loss) from continuing operations, net of tax	\$ (297)	\$ 438	\$ 228	\$ (176)	\$ 193



**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

(Dollars in millions)	Three Months Ended June 30, 2011				
	Credit Card	Consumer Banking	Commercial Banking	Other	Total
Net interest income (expense)	\$ 1,890	\$ 1,051	\$ 388	\$ (193)	\$ 3,136
Non-interest income (expense)	619	194	62	(18)	857
Total net revenue	2,509	1,245	450	(211)	3,993
Provision for credit losses	309	41	(19)	12	343
Non-interest expense:					
Core deposit intangible amortization	0	34	10	0	44
Other non-interest expense	1,238	724	212	37	2,211
Total non-interest expense	1,238	758	222	37	2,255
Income (loss) from continuing operations before income taxes	962	446	247	(260)	1,395
Income tax provision (benefit)	344	159	88	(141)	450
Income (loss) from continuing operations, net of tax	\$ 618	\$ 287	\$ 159	\$ (119)	\$ 945

(Dollars in millions)	Six Months Ended June 30, 2012				
	Credit Card	Consumer Banking	Commercial Banking	Other	Total
Net interest income (expense)	\$ 4,342	\$ 2,784	\$ 858	\$ (569)	\$ 7,415
Non-interest income (expense)	1,369	361	167	678	2,575
Total net revenue	5,711	3,145	1,025	109	9,990
Provision for credit losses	2,169	218	(163)	26	2,250
Non-interest expense:					
Core deposit intangible amortization	0	79	18	0	97
Other non-interest expense	3,131	1,823	494	101	5,549
Total non-interest expense	3,131	1,902	512	101	5,646
Income (loss) from continuing operations before income taxes	411	1,025	676	(18)	2,094
Income tax provision (benefit)	142	363	238	(347)	396
Income from continuing operations, net of tax	\$ 269	\$ 662	\$ 438	\$ 329	\$ 1,698

(Dollars in millions)	Six Months Ended June 30, 2011				
	Credit Card	Consumer Banking	Commercial Banking	Other	Total
Net interest income (expense)	\$ 3,831	\$ 2,034	\$ 764	\$ (353)	\$ 6,276
Non-interest income (expense)	1,293	380	133	(7)	1,799

Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Total net revenue	5,124	2,414	897	(360)	8,075
Provision for credit losses	759	136	(35)	17	877
Non-interest expense:					
Core deposit intangible amortization	0	68	21	0	89
Other non-interest expense	2,416	1,430	413	69	4,328
Total non-interest expense	2,416	1,498	434	69	4,417
Income (loss) from continuing operations before income taxes	1,949	780	498	(446)	2,781
Income tax provision (benefit)	688	278	177	(339)	804
Income (loss) from continuing operations, net of tax	\$ 1,261	\$ 502	\$ 321	\$ (107)	\$ 1,977

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)****Business Segment Loans and Deposits**

The total loan and deposit amounts attributable to each of our reportable business segments as of June 30, 2012 and December 31, 2011 are presented in the following tables:

(Dollars in millions)	June 30, 2012				Total Reported
	Credit Card	Consumer Banking	Commercial Banking	Other	
Loans held for investment	\$ 88,914	\$ 77,615	\$ 36,056	\$ 164	\$ 202,749
Total deposits	0	173,966	27,784	12,181	213,931

(Dollars in millions)	December 31, 2011				Total Reported
	Credit Card	Consumer Banking	Commercial Banking	Other	
Loans held for investment	\$ 65,075	\$ 36,315	\$ 34,327	\$ 175	\$ 135,892
Total deposits	0	88,540	26,683	13,003	128,226

**NOTE 15 COMMITMENTS, CONTINGENCIES AND GUARANTEES****Letters of Credit**

We had contractual amounts of standby letters of credit and commercial letters of credit of \$1.8 billion and \$1.9 billion as of June 30, 2012 and December 31, 2011. As of June 30, 2012, financial guarantees had expiration dates ranging from 2012 to 2023. The fair value of the guarantees outstanding, which are included in our condensed consolidated balance sheets, other liabilities was \$5 million as of June 30, 2012.

**Contingent Payments Related to Acquisitions and Partnership Agreements**

Certain of our acquisition and partnership agreements include contingent payment provisions in which we agree to provide future payments, up to a maximum amount, based on certain performance criteria. Our contingent payment arrangements are generally based on the difference between the expected credit performance of specified loan portfolios as of the date of the applicable agreement and the actual future performance. To the extent that actual losses associated with these portfolios are less than the expected level, we agree to share a portion of the benefit with the seller. The maximum contingent payment amount related to our acquisitions totaled \$330 million as of June 30, 2012. The actual payment amount related to \$30 million of this balance will be determined as of September 30, 2013. The actual payment amount related to the remaining \$300 million of this balance will be determined as of December 31, 2013. We recognized expense related to contingent payment arrangements of \$25 million during the second quarter of 2012. As such, we had a liability for contingent payments related to these arrangements of \$125 million and \$88 million as of June 30, 2012 and December 31, 2011, respectively.

**Potential Mortgage Representation & Warranty Liabilities**



## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

In recent years, we acquired three subsidiaries that originated residential mortgage loans and sold them to various purchasers, including purchasers who created securitization trusts. These subsidiaries are Capital One Home Loans, which was acquired in February 2005; GreenPoint Mortgage Funding, Inc. ( GreenPoint ), which was acquired in December 2006 as part of the North Fork acquisition; and Chevy Chase Bank, which was acquired in February 2009 and subsequently merged into CONA.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

In connection with their sales of mortgage loans, the subsidiaries entered into agreements containing varying representations and warranties about, among other things, the ownership of the loan, the validity of the lien securing the loan, the loan's compliance with any applicable loan criteria established by the purchaser, including underwriting guidelines and the ongoing existence of mortgage insurance, and the loan's compliance with applicable federal, state and local laws. The representations and warranties do not address the credit performance of the mortgage loans, but mortgage loan performance often influences whether a claim for breach of representation and warranty will be asserted and has an effect on the amount of any loss in the event of a breach of a representation or warranty.

Each of these subsidiaries may be required to repurchase mortgage loans in the event of certain breaches of these representations and warranties. In the event of a repurchase, the subsidiary is typically required to pay the then unpaid principal balance of the loan together with interest and certain expenses (including, in certain cases, legal costs incurred by the purchaser and/or others). The subsidiary then recovers the loan or, if the loan has been foreclosed, the underlying collateral. The subsidiary is exposed to any losses on the repurchased loans after giving effect to any recoveries on the collateral. In some instances, rather than repurchase the loans, a subsidiary may agree to make a cash payment to make an investor whole on losses or to settle repurchase claims. In addition, our subsidiaries may be required to indemnify certain purchasers and others against losses they incur as a result of certain breaches of representations and warranties. In some cases, the amount of such losses could exceed the repurchase amount of the related loans.

These subsidiaries, in total, originated and sold to non-affiliates approximately \$111 billion original principal balance of mortgage loans between 2005 and 2008, which are the years (or vintages) with respect to which our subsidiaries have received the vast majority of the repurchase requests and other related claims.

The following table presents the original principal balance of mortgage loan originations, by vintage, for 2005 through 2008, for the three general categories of purchasers of mortgage loans and the outstanding principal balance as of June 30, 2012 and December 31, 2011:

**Unpaid Principal Balance of Mortgage Loans Originated and Sold to Third Parties Based on Category of Purchaser**

(Dollars in billions)	Unpaid Principal Balance		Total	Original Unpaid Principal Balance			
	June 30, 2012	December 31, 2011		2008	2007	2006	2005
Government sponsored enterprises ( GSEs <sup>(1)</sup> )	\$ 5	\$ 5	\$ 11	\$ 1	\$ 4	\$ 3	\$ 3
Insured Securitizations	5	6	19	0	2	8	9
Uninsured Securitizations and Other	26	30	81	3	15	30	33
Total	\$ 36	\$ 41	\$ 111	\$ 4	\$ 21	\$ 41	\$ 45

<sup>(1)</sup> GSEs include Fannie Mae and Freddie Mac.

Between 2005 and 2008, our subsidiaries sold an aggregate amount of \$11 billion in original principal balance mortgage loans to the GSEs.

Of the \$19 billion in original principal balance of mortgage loans sold directly by our subsidiaries to private-label purchasers who placed the loans into securitizations supported by bond insurance ( Insured Securitizations ), approximately \$16 billion original principal balance was placed in securitizations as to which the monoline bond insurers have made repurchase requests or loan file requests to one of our subsidiaries ( Active Insured

---

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

Securitized ), and the remaining approximately \$3 billion original principal balance was placed in securitizations as to which the monoline bond insurers have not made repurchase requests or loan file requests to one of our subsidiaries ( Inactive Insured Securitized ). Insured Securitized often allow the monoline bond insurer to act independently of the investors. Bond insurers typically have indemnity agreements directly with both the mortgage originators and the securitizers, and they often have super-majority rights within the trust documentation that allow them to direct trustees to pursue mortgage repurchase requests without coordination with other investors.

Because we do not service most of the loans our subsidiaries sold to others, we do not have complete information about the current ownership of the \$81 billion in original principal balance of mortgage loans not sold directly to GSEs or placed in Insured Securitized. We have determined based on information obtained from third-party databases that about \$50 billion original principal balance of these mortgage loans are currently held by private-label publicly issued securitizations not supported by bond insurance ( Uninsured Securitized ). In contrast with the bond insurers in Insured Securitized, investors in Uninsured Securitized often face a number of legal and logistical hurdles before they can direct a securitization trustee to pursue mortgage repurchases, including the need to coordinate with a certain percentage of investors holding the securities and to indemnify the trustee for any litigation it undertakes. Despite these legal and logistical hurdles, there is a risk that securitization trustees will pursue mortgage repurchases unilaterally. An additional approximately \$21 billion original principal balance of mortgage loans were initially sold to private investors as whole loans. Of this amount, we believe approximately \$10 billion original principal balance of mortgage loans were ultimately purchased by GSEs. For purposes of our reserves-setting process, we consider these loans to be private-label loans rather than GSE loans. Various known and unknown investors purchased the remaining \$10 billion original principal balance of mortgage loans in this category.

With respect to the \$111 billion in original principal balance of mortgage loans originated and sold to others between 2005 and 2008, we estimate that approximately \$36 billion in unpaid principal balance remains outstanding as of June 30, 2012, approximately \$16 billion in losses have been realized and approximately \$10 billion in unpaid principal balance is at least 90 days delinquent. Because we do not service most of the loans we sold to others, we do not have complete information about the underlying credit performance levels for some of these mortgage loans. These amounts reflect our best estimates, including extrapolations where necessary. These extrapolations occur on the approximately \$10 billion original principal balance of mortgage loans for which we do not have complete information about the current holders or the underlying credit performance. These estimates could change as we receive additional data or refine our analysis.

The subsidiaries had open repurchase requests relating to approximately \$2.5 billion original principal balance of mortgage loans as of June 30, 2012, compared with \$2.3 billion as of March 31, 2012 and compared with \$2.1 billion as of December 31, 2011. As of June 30, 2012, the majority of new repurchase demands received over the last year and, as discussed below, the majority of our \$1.0 billion reserve relates to the \$27 billion of original principal balance of mortgage loans originally sold to the GSEs or to Active Insured Securitized. Currently, repurchase demands predominantly relate to the 2006 and 2007 vintages. We have received relatively few repurchase demands from the 2008 and 2009 vintages. We believe this is because GreenPoint ceased originating mortgages in August 2007.

**Table of Contents****CAPITAL ONE FINANCIAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

The following table presents information on pending repurchase requests by counterparty category and timing of initial repurchase request. The amounts presented are based on original loan principal balances.

**Open Pipeline All Vintages (all entities)<sup>(1)</sup>**

(Dollars in millions) (All amounts are Original Principal Balance)	GSEs	Insured Securitized	Uninsured Securitized and Other	Total
Open claims as of December 31, 2010	\$ 126	\$ 832	\$ 665	\$ 1,623
Gross new demands received	196	359	131	686
Loans repurchased/made whole	(67)	(14)	(16)	(97)
Demands rescinded	(85)	(6)	(30)	(121)
Reclassifications <sup>(2)</sup>	6	72	(78)	0
Open claims as of December 31, 2011	\$ 176	\$ 1,243	\$ 672	\$ 2,091
Gross new demands received	151	336	184	671
Loans repurchased/made whole	(215)	0	(26)	(241)
Demands rescinded	(46)	0	(22)	(68)
Reclassifications <sup>(2)</sup>	(2)	0	3	1
Open claims as of June 30, 2012	\$ 64	\$ 1,579	\$ 811	\$ 2,454

<sup>(1)</sup> The open pipeline includes all repurchase requests ever received by our subsidiaries where either the requesting party has not formally rescinded the repurchase request and where our subsidiary has not agreed to either repurchase the loan at issue or make the requesting party whole with respect to its losses. Accordingly, repurchase requests denied by our subsidiaries and not pursued by the counterparty remain in the open pipeline. Moreover, repurchase requests submitted by parties without contractual standing to pursue repurchase requests are included within the open pipeline unless the requesting party has formally rescinded its repurchase request. Finally, the amounts reflected in this chart are the original principal balance amounts of the mortgage loans at issue and do not correspond to the losses our subsidiary would incur upon the repurchase of these loans.

<sup>(2)</sup> Represents adjustments to correct the counterparty category as of June 30 2012 and December 31, 2011 for amounts that were misclassified. The reclassification had no impact on the total pending repurchase requests.

We have established representation and warranty reserves for losses associated with the mortgage loans sold by each subsidiary that we consider to be both probable and reasonably estimable, including both litigation and non-litigation liabilities. These reserves are reported in our consolidated balance sheets as a component of other liabilities. The reserve setting process relies heavily on estimates, which are inherently uncertain, and requires the application of judgment. We evaluate these estimates on a quarterly basis. We build our representation and warranty reserves through the provision for repurchase losses, which we report in our consolidated statements of income as a component of non-interest income for loans originated and sold by Chevy Chase Bank and Capital One Home Loans and as a component of discontinued operations for loans originated and sold by GreenPoint. In establishing the representation and warranty reserves, we consider a variety of factors depending on the category of purchaser.

In establishing reserves for the \$11 billion original principal balance of GSE loans, we rely on the historical relationship between GSE loan losses and repurchase outcomes for each GSE, adjusted for any bulk settlements, to estimate: (1) the percentage of current and future GSE loan defaults that we anticipate will result in repurchase requests from the GSEs over the lifetime of the GSE loans; and (2) the percentage of those repurchase requests that we anticipate will result in actual repurchases. We also rely on estimated collateral valuations and loss forecast models to estimate our lifetime liability on GSE loans. This reserving approach to the GSE loans reflects the historical interaction with the GSEs around

repurchase requests, and also includes anticipated repurchases resulting from mortgage insurance rescissions. The GSEs typically have stronger contractual rights than

**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

non-GSE counterparties because GSE contracts typically do not contain prompt notice requirements for repurchase requests or materiality qualifications to the representations and warranties.

Moreover, for the potential GSE repurchase liability remaining after bulk settlements, we have established a negotiation pattern whereby the GSEs and our subsidiaries continually negotiate around individual repurchase requests, leading to the GSEs rescinding some repurchase requests and our subsidiaries agreeing in some cases to repurchase some loans or make the GSEs whole with respect to losses. Our lifetime representation and warranty reserves with respect to GSE repurchase liability remaining after bulk settlements is grounded in this history. One of our subsidiaries entered into a bulk settlement with a GSE to resolve present and future repurchase claims in the first quarter of 2012, and our reserves allocated to the GSE segment reflect the amount of that settlement.

For the \$16 billion original principal balance in Active Insured Securitizations, our reserving approach also reflects our historical interaction with monoline bond insurers around repurchase requests. Typically, monoline bond insurers allege a very high repurchase rate with respect to the mortgage loans in the Active Insured Securitization category. In response to these repurchase requests, our subsidiaries typically request information from the monoline bond insurers demonstrating that the contractual requirements around a valid repurchase request have been satisfied. In response to these requests for supporting documentation, monoline bond insurers typically initiate litigation. Accordingly, our reserves within the Active Insured Securitization segment are not based upon the historical repurchase rate with monoline bond insurers, but rather upon the expected resolution of litigation with the monoline bond insurers. Every bond insurer within this category is pursuing a substantially similar litigation strategy either through active or probable litigation. Accordingly, our representation and warranty reserves for this category are litigation reserves. In establishing litigation reserves for this category each quarter, we consider current and future losses inherent within the securitization and apply legal judgment to the actual and anticipated factual and legal record to estimate the lifetime legal liability for each securitization. Our estimated legal liability for each securitization within this category assumes that we will be responsible for only a portion of the losses inherent in each securitization. Our litigation reserves with respect to both the U.S. Bank Litigation and the DBSP Litigation, in each case as referenced below, are contained within the Active Insured Securitization reserve category. Further, our litigation reserves with respect to indemnification risks from certain representation and warranty lawsuits brought by monoline bond insurers against third-party securitizations sponsors, where one of our subsidiaries provided some or all of the mortgage collateral within the securitization but is not a defendant in the litigation, are also contained within this category.

For the \$3 billion original principal balance of mortgage loans in the Inactive Insured Securitizations category and the \$81 billion original principal balance of mortgage loans in the Uninsured Securitizations and other whole loan sales categories, we establish reserves by relying on our historical activity and repurchase rates to estimate repurchase liabilities over the next twelve (12) months. We do not believe we can estimate repurchase liability for these categories for a period longer than twelve (12) months because of the relatively irregular nature of repurchase activity within these categories. Some Uninsured Securitization investors from this category who have not made repurchase requests or filed representation and warranty lawsuits are currently suing investment banks and securitization sponsors under federal and/or state securities laws. Although we face some direct and indirect indemnity risks from these litigations, we generally have not established reserves with respect to these indemnity risks because we do not consider them to be both probable and reasonably estimable liabilities.

The aggregate reserves for all three subsidiaries were \$1.0 billion as of June 30, 2012, as compared with \$1.1 billion as of March 31, 2012, and \$943 million as of December 31, 2011. We recorded a total provision for repurchase losses for our representation and warranty repurchase exposure of \$180 million and \$349 million for the three and six months ended June 30, 2012, respectively, driven by updated estimates of anticipated outcomes from various litigation and threatened litigation in the insured securitization segment based on relevant factual

Table of Contents

## CAPITAL ONE FINANCIAL CORPORATION

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)

and legal developments and an increased reserve associated with a first quarter settlement between a subsidiary and a GSE to resolve present and future repurchase claims.

During the three and six months ended June 30, 2012, we had settlements of repurchase requests totaling \$279 million and \$290 million, respectively, that were charged against the reserve. The table below summarizes changes in our representation and warranty reserves for the three and six months ended June 30, 2012 and 2011, and for full year 2011:

**Changes in Representation and Warranty Reserves**

(Dollars in millions)	Three Months Ended June 30,		Six Months Ended June 30,		Full Year 2011
	2012	2011	2012	2011	
Representation and warranty repurchase reserve, beginning of period <sup>(1)</sup>	\$ 1,101	\$ 846	\$ 943	\$ 816	\$ 816
Provision for repurchase losses <sup>(2)</sup>	180	37	349	81	212
Net realized losses	(279)	(14)	(290)	(28)	(85)
Representation and warranty repurchase reserve, end of period <sup>(1)</sup>	\$ 1,002	\$ 869	\$ 1,002	\$ 869	\$ 943

<sup>(1)</sup> Reported in our consolidated balance sheets as a component of other liabilities.

<sup>(2)</sup> The pre-tax portion of the provision for mortgage repurchase claims recognized in our consolidated statements of income as a component of non-interest income totaled \$26 million and \$42 million for the three and six months ended June 30, 2012, respectively, and \$4 million and \$9 million for the three and six months ended June 30, 2011, respectively. The pre-tax portion of the provision for mortgage repurchase claims recognized in our consolidated statements of income as a component of discontinued operations totaled \$154 million and \$307 million for the three and six months ended June 30, 2012, respectively, and \$33 million and \$72 million for the three and six months ended June 30, 2011, respectively.

As indicated in the table below, most of the reserves relate to the mortgage loans sold directly to the GSEs and to the mortgage loans sold to purchasers who placed them into Active Insured Securitizations.

**Allocation of Representation and Warranty Reserves**

(Dollars in millions, except for loans sold)	Reserve Liability		Loans Sold 2005 to 2008 <sup>(1)</sup>
	June 30, 2012	December 31, 2011	
GSEs and Active Insured Securitizations	\$ 821	\$ 778	\$ 27
Inactive Insured Securitizations and Others	181	165	84
Total	\$ 1,002	\$ 943	\$ 111

<sup>(1)</sup>

## Edgar Filing: CAPITAL ONE FINANCIAL CORP - Form 10-Q

Reflects, in billions, the total original principal balance of mortgage loans originated by our subsidiaries and sold to third party investors between 2005 and 2008.

The adequacy of the reserves and the ultimate amount of losses incurred by our subsidiaries will depend on, among other things, actual future mortgage loan performance, the actual level of future repurchase and indemnification requests (including the extent, if any, to which Inactive Insured Securitizations and other currently inactive investors ultimately assert claims), the actual success rates of claimants, developments in litigation, actual recoveries on the collateral and macroeconomic conditions (including unemployment levels and housing prices).



**Table of Contents**

**CAPITAL ONE FINANCIAL CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

As part of our business planning processes, we have considered variou