CAPITAL ONE FINANCIAL CORP
Form 10-Q
August 08, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008.

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED).**

For the transition period from ______ to ______

Commission File No. 1-13300

CAPITAL ONE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

(703) 720-1000

Registrant s telephone number, including area code:

(Not applicable)

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

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

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

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

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

As of July 31, 2008 there were 375,735,077 shares of the registrant s Common Stock, par value $.01 per share, outstanding.

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Part 1. Financial Information

Item 1. ***Financial Statements***
CAPITAL ONE FINANCIAL CORPORATION

Consolidated Balance Sheets

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

	June 30 2008	December 31 2007
Assets:		
Cash and due from banks	**$ 2,280,244**	$ 2,377,287
Federal funds sold and resale agreements	**1,526,799**	1,766,762
Interest-bearing deposits at other banks	**717,572**	677,360
Cash and cash equivalents	**4,524,615**	4,821,409
Securities available for sale	**25,028,853**	19,781,587
Mortgage loans held for sale	**111,824**	315,863
Loans held for investment	**97,065,238**	101,805,027
Less: Allowance for loan and lease losses	**(3,311,003)**	(2,963,000)
Net loans held for investment	**93,754,235**	98,842,027
Accounts receivable from securitizations	**5,301,906**	4,717,879
Premises and equipment, net	**2,321,487**	2,299,603
Interest receivable	**778,595**	839,317
Goodwill	**12,826,738**	12,830,740
Other	**6,466,018**	6,141,944
Total assets	**$ 151,114,271**	$ 150,590,369
Liabilities:		
Non-interest-bearing deposits	**$ 10,752,059**	$ 11,046,549
Interest-bearing deposits	**81,655,001**	71,714,627
Total deposits	**92,407,060**	82,761,176
Senior and subordinated notes	**8,506,339**	10,712,706
Other borrowings	**19,302,185**	26,812,969
Interest payable	**621,489**	631,609
Other	**5,355,733**	5,377,797
Total liabilities	**126,192,806**	126,296,257
Stockholders Equity:		
Preferred stock, par value $.01 per share; authorized 50,000,000 shares, none issued or outstanding		
Common stock, par value $.01 per share; authorized 1,000,000,000 shares 422,298,620 and 419,224,900 issued as of June 30, 2008 and December 31, 2007, respectively	**4,223**	4,192
Paid-in capital, net	**15,966,810**	15,860,490
Retained earnings	**11,988,877**	11,267,568
Cumulative other comprehensive income	**126,603**	315,248
	(3,165,048)	(3,153,386)

Less: Treasury stock, at cost; 46,613,874 shares and 46,370,635 shares as of June 30, 2008 and December 31, 2007, respectively		
Total stockholders equity	**24,921,465**	24,294,112
Total liabilities and stockholders equity	**$ 151,114,271**	$ 150,590,369

See Notes to Consolidated Financial Statements.

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CAPITAL ONE FINANCIAL CORPORATION

Consolidated Statements of Income

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

	Three Months Ended June 30		Six Months Ended June 30	
	2008	**2007**	**2008**	**2007**
Interest Income:				
Loans held for investment, including past-due fees	**$ 2,297,709**	$ 2,255,573	**$ 4,806,102**	$ 4,582,253
Securities available for sale	**281,089**	237,978	**538,836**	442,058
Other	**113,059**	145,135	**226,444**	326,684
Total interest income	**2,691,857**	2,638,686	**5,571,382**	5,350,995
Interest Expense:				
Deposits	**592,576**	749,603	**1,202,965**	1,480,086
Senior and subordinated notes	**114,797**	134,061	**255,767**	272,607
Other borrowings	**256,728**	216,441	**572,977**	455,178
Total interest expense	**964,101**	1,100,105	2,031,709	2,207,871
Net interest income	**1,727,756**	1,538,581	**3,539,673**	3,143,124
Provision for loan and lease losses	**829,130**	396,713	**1,908,202**	746,758
Net interest income after provision for loan and lease losses	**898,626**	1,141,868	**1,631,471**	2,396,366
Non-Interest Income:				
Servicing and securitizations	**834,740**	1,226,896	**1,917,802**	2,214,978
Service charges and other customer-related fees	**524,209**	482,979	**1,098,270**	962,446
Mortgage servicing and other	**16,552**	103,653	**51,807**	155,103
Interchange	**132,730**	125,979	**284,632**	244,090
Other	**114,085**	32,344	**326,283**	169,604
Total non-interest income	**1,622,316**	1,971,851	**3,678,794**	3,746,221
Non-Interest Expense:				
Salaries and associate benefits	**578,572**	667,904	**1,189,852**	1,343,075
Marketing	**288,100**	326,067	**585,893**	656,961
Communications and data processing	**195,102**	192,620	**382,345**	374,854
Supplies and equipment	**131,937**	116,434	**262,868**	250,332
Occupancy	**80,137**	75,843	**168,217**	153,238
Restructuring Expense	**13,560**	91,074	**66,319**	91,074
Other	**532,193**	564,593	**986,384**	1,139,048
Total non-interest expense	**1,819,601**	2,034,535	**3,641,878**	4,008,582
Income from continuing operations before income taxes	**701,341**	1,079,184	**1,668,387**	2,134,005
Income taxes	**238,843**	311,572	**573,334**	680,269
Income from continuing operations, net of tax	**462,498**	767,612	**1,095,053**	1,453,736
Loss from discontinued operations, net of tax	**(9,593)**	(17,240)	**(93,644)**	(28,314)
Net income	**$ 452,905**	$ 750,372	**$ 1,001,409**	$ 1,425,422

Basic earnings per share:								
Income from continuing operations	**$**	**1.24**	$	1.96	**$**	**2.95**	$	3.64
Loss from discontinued operations		**(0.03)**		(0.04)		**(0.25)**		(0.07)
Net Income	**$**	**1.21**	$	1.92	**$**	**2.70**	$	3.57
Diluted earnings per share								
Income from continuing operations	**$**	**1.24**	$	1.93	**$**	**2.94**	$	3.58
Loss from discontinued operations		**(0.03)**		(0.04)		**(0.25)**		(0.07)
Diluted earnings per share	**$**	**1.21**	$	1.89	**$**	**2.69**	$	3.51
Dividends paid per share	**$**	**0.375**	$	0.03	**$**	**0.75**	$	0.05

See Notes to Consolidated Financial Statements.

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CAPITAL ONE FINANCIAL CORPORATION

Consolidated Statements of Changes in Stockholders Equity

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

(In Thousands, Except Per Share Data)	Common Stock Shares	Common Stock Amount	Paid-In Capital, Net	Retained Earnings	Cumulative Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
Balance, December 31, 2006	412,219,973	$ 4,122	$ 15,333,137	$ 9,760,184	$ 266,180	$ (128,417)	$ 25,235,206
Cumulative effect from adoption of FIN 48				(31,830)			(31,830)
Cumulative effect from adoption of FAS 156, net of income taxes of $6,378				8,809			8,809
Comprehensive income:							
Net income				1,425,422			1,425,422
Other comprehensive income, net of income tax:							
Unrealized loss on securities, net of income taxes benefit of $62,652					(107,818)		(107,818)
Defined benefit pension plans					(1,352)		(1,352)
Foreign currency translation adjustments					73,298		73,298
Unrealized gains on cash flow hedging instruments, net of income tax of $9,090					15,123		15,123
Other comprehensive income					(20,749)		(20,749)
Comprehensive income							1,404,673
Cash dividends-$.03 per share				(21,391)			(21,391)
Purchase of treasury stock						(1,757,730)	(1,757,730)
Issuances of common stock and restricted stock, net of forfeitures	1,063,803	11	18,618				18,629

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(In Thousands, Except Per Share Data)	Common Stock Shares	Common Stock Amount	Paid-In Capital, Net	Retained Earnings	Cumulative Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
Exercise of stock options and related tax benefits of exercises and restricted stock vesting	4,207,243	42	229,320				229,362
Compensation expense for restricted stock awards and stock options			108,159				108,159
Adjustment to issuance of common stock for acquisition	(136,243)	(1)	(10,386)				(10,387)
Allocation of ESOP shares			3,161				3,161
Balance, June 30, 2007	417,354,776	$ 4,174	$ 15,682,009	$ 11,141,194	$ 245,431	$ (1,886,147)	$ 25,186,661
Balance, December 31, 2007	**419,224,900**	**$ 4,192**	**$ 15,860,490**	**$ 11,267,568**	**$ 315,248**	**$ (3,153,386)**	**$ 24,294,112**
Adjustment to initially apply the measurement date provisions of FAS 158, net of income tax benefit of $317				**572**	**(1,161)**		**(589)**
Comprehensive income:							
Net income				**1,001,409**			**1,001,409**
Other comprehensive income, net of income tax:							
Unrealized losses on securities, net of income tax benefit of $82,865					**(153,892)**		**(153,892)**
Defined benefit pension plans, net of income tax benefit of $1,388					**(2,730)**		**(2,730)**
Foreign currency translation adjustments					**(29,358)**		**(29,358)**
Unrealized losses in cash flow hedging instruments, net of income tax benefit of $810					**(1,504)**		**(1,504)**
Other comprehensive income					**(187,484)**		**(187,484)**
Comprehensive income							**813,925**
Cash dividends - $0.375 per share				**(280,671)**			**(280,671)**
Purchase of treasury stock						**(11,662)**	**(11,662)**

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(In Thousands, Except Per Share Data)	Common Stock Shares	Common Stock Amount	Paid-In Capital, Net	Retained Earnings	Cumulative Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
Issuances of common stock and restricted stock, net of forfeitures	**1,493,355**	**15**	**18,561**				**18,576**
Exercise of stock options and tax benefits of exercises and restricted stock vesting	**1,580,365**	**16**	**47,259**				**47,275**
Compensation expense for restricted stock awards and stock options			**37,349**				**37,349**
Allocation of ESOP shares			**3,150**				**3,150**
Balance, June 30, 2008	**422,298,620**	**$ 4,223**	**$ 15,966,809**	**$ 11,988,878**	**$ 126,603**	**$ (3,165,048)**	**$ 24,921,465**

See Notes to Consolidated Financial Statements.

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CAPITAL ONE FINANCIAL CORPORATION

Consolidated Statements of Cash Flows

(Dollars in thousands) (unaudited)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Operating Activities:		
Income from continuing operations, net of tax	**$ 1,095,053**	$ 1,453,736
Loss from discontinued operations, net of tax	**(93,644)**	(28,314)
Net Income	**1,001,409**	1,425,422
Adjustments to reconcile net income to cash provided by operating activities:		
Provision for loan and lease losses	**1,908,202**	746,758
Depreciation and amortization, net	**361,133**	323,303
Gains on sales of securities available for sale	**(12,790)**	(66,857)
Gains on sales of auto loans	**(2,125)**	(10,285)
Gains on repurchase of senior notes	**(53,289)**	(17,444)
Mortgage loans held for sale:		
Transfers and originations	**(1,247,090)**	(2,402,338)
(Gain) loss on sales	**(21,158)**	62,442
Proceeds from sales	**1,479,198**	7,862,501
Stock plan compensation expense	**54,780**	258,515
Changes in assets and liabilities:		
Decrease in interest receivable	**60,722**	49,260
Increase in accounts receivable from securitizations	**(584,027)**	(897,094)
Increase in other assets	**(328,525)**	(357,405)
Decrease in interest payable	**(10,120)**	(31,145)
(Decrease) increase in other liabilities	**(72,984)**	521,394
Net cash (used in) provided by operating activities attributable to discontinued operations	**(19,640)**	1,979,914
Net cash provided by operating activities	**2,513,696**	9,446,941
Investing Activities:		
Purchases of securities available for sale	**(11,277,343)**	(9,329,173)
Proceeds from maturities of securities available for sale	**3,559,824**	3,672,539
Proceeds from sales of securities available for sale	**2,266,004**	544,449
Proceeds from securitizations of loans	**4,993,667**	7,060,100
Net increase in loans held for investment	**(2,212,015)**	(2,655,949)
Principal recoveries of loans previously charged off	**333,172**	321,430
Additions of premises and equipment, net	**(203,047)**	(203,380)
Net payments for companies acquired		(14,787)
Net cash provided by (used in) investing activities attributable to discontinued operations	**11,683**	(688,687)
Net cash used in investing activities	**(2,528,055)**	(1,293,458)
Financing Activities:		
Net increase (decrease) in deposits	**9,645,884**	(90,460)
Net decrease in other borrowings	**(7,518,432)**	(2,151,800)
Maturities of senior notes	**(1,118,694)**	(462,500)
Repurchases of senior notes	**(1,064,597)**	
Purchases of treasury stock	**(11,662)**	(1,757,730)

Dividends paid	**(280,671)**	(21,391)
Net proceeds from issuances of common stock	**21,726**	21,790
Proceeds from share based payment activities	**37,349**	101,170
Net cash used in financing activities attributable to discontinued operations	**6,662**	(1,405,236)
Net cash used in financing activities	**(282,435)**	(5,766,157)
Net (decrease) increase in cash and cash equivalents	**(296,794)**	2,387,326
Cash and cash equivalents at beginning of year	**4,821,409**	4,660,496
Cash and cash equivalents at end of year	**$ 4,524,615**	$ 7,047,822

See Notes to Consolidated Financial Statements.

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CAPITAL ONE FINANCIAL CORPORATION

Notes to Consolidated Financial Statements

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

Note 1

Significant Accounting Policies

Business

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

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

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

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

In the third quarter of 2007, the Corporation shut down the mortgage origination operations of its wholesale mortgage banking unit, GreenPoint Mortgage (GreenPoint), an operating subsidiary of CONA. Additional information can be found in Note 2 Discontinued Operations.

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

Basis of Presentation

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

The Consolidated Financial Statements include the accounts of Capital One Financial Corporation and its majority owned subsidiaries. Investments in unconsolidated entities where the Company has the ability to exercise significant influence over the operations of the investee are accounted for using the equity method of accounting. This includes interests in variable interest entities (VIEs) where the Company is not the primary beneficiary. Investments not meeting the criteria for equity method accounting are accounted for using the cost method of accounting. Investments in unconsolidated entities are included in other assets, and the Company s share of income or loss is recorded in other non-interest income. All significant intercompany balances and transactions have been eliminated. Certain prior years amounts have been reclassified to conform to the 2008 presentation. All amounts in the following notes, excluding per share data, are presented in thousands.

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

Special Purpose Entities and Variable Interest Entities

Special purpose entities are broadly defined as legal entities structured for a particular purpose. The Company uses special purpose entities primarily to conduct off-balance sheet securitization activities. Special purpose entities that meet the criteria

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

In April 2008, The Financial Accounting Standards Board (FASB) voted to eliminate Qualifying Special Purpose Entities (QSPEs) from the guidance. While the proposed revised standard has not been released or finalized and the FASB s proposals will be subject to a public comment period, this change may have a significant impact on the Company s consolidated financial statements as the Company may lose sales treatment for assets previously sold to a QSPE, as well as for future sales. This proposed revision could be effective as early as January 2010. As of June 30, 2008, the total assets of QSPEs to which the Company has transferred and received sales treatment were $50.2 billion.

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

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

Recent Accounting Pronouncements

Effective January 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157) for all financial assets and liabilities and for nonfinancial assets and liabilities measured at fair value on a recurring basis. Under FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* (FSP 157-2), the Company elected to defer the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities measured on a nonrecurring basis. SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. The initial adoption of SFAS 157 did not have a material impact on the consolidated earnings and financial position of the Company. There are no material assets or liabilities recognized or disclosed at fair value for which the Company has not applied the provisions of SFAS 157. See Note 6 for additional detail.

Effective January 1, 2008, the Company adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Li*