



Capital One Bank (Europe) plc Pillar 3 Summary Disclosures



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1. Introduction

Capital One Bank (Europe) plc (COBEP) adopted the new Basel II Capital Requirements Directive (CRD) on 1st January 2008. This legislative framework is designed to be more risk sensitive and representative of the risk management practices that banks and building societies pursue.

The framework consists of three ‘pillars’:

Capital Requirements Directive		
Pillar 1	Pillar 2	Pillar 3
Minimum Capital Requirements	Supervisory Review Process	Disclosure

Pillar 1 includes detailed requirements specifying the minimum capital requirement firms are required to meet relating to credit, market and operational risk.

Pillar 2 specifies the process that firms and their supervisors must follow to ensure they are holding sufficient capital against risks that are not specifically covered in Pillar 1.

Pillar 3 details disclosure requirements that firms must make in relation to their risks and their policies regarding capital and risk management.

This document provides the required Pillar 3 disclosures in accordance with Chapter 11 of the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU).

COBEP has made use of the provisions laid down in BIPRU 2.1 (Solo consolidation waiver) to provide resources and requirements to the FSA under a solo consolidation basis. The following entities, all of which are wholly owned subsidiaries, are included within the solo consolidated group:

- Capital One Bank (Europe) plc
- Capital One Loans (UK) Limited
- Capital One Homeowner Loans Limited
- Capital One Mortgages Limited
- Capital One Overseas Limited
- Capital One Securities Limited

2. Risk management policies and objectives

COBEP provides a range of banking, financial and related services in the UK. COBEP’s ultimate parent company is Capital One Financial Corporation, incorporated in the United States of America.

It is the policy of COFC to identify, aggregate, and mitigate risks that affect or have the potential to affect its businesses and to target returns commensurate with the risks COFC takes. To achieve this COFC has adopted an Enterprise Risk Management (ERM) programme which applies to the entire global organisation and is formalised in an Enterprise Risk Management (ERM) Policy.

COFC uses a consistent risk management and control framework (RMCF) to manage risk. The framework applies at all levels, from the development of the enterprise risk management programme itself to the tactical operations of a front-line business team.

The COFC Board of Directors is ultimately responsible for establishing Capital One’s overall risk framework, authorising, approving and overseeing the execution of the ERM Policy, reviewing Capital One’s risk profile and establishing the high level risk appetite. The COBEP Board of Directors fulfils these responsibilities on behalf of the COBEP business. The diagram below shows the governance structure that supports the COBEP Board in fulfilling this responsibility:

Governance Structure						
	Board of Directors					
Risk Steward	Chief Risk Officer, UK		Chief Credit Officer	Chief Financial Officer	Principal Managing Director	Audit Committee
Advisory Committee	Compliance Committee	Enterprise Risk Management Committee	UK Divisional Credit Committee	Asset Liability Committee	UK Leadership Team	Corporate Audit Services
Risks covered	Compliance Risk	Operational Risk Legal Risk Reputational Risk	Credit Risk	Market Risk Liquidity Risk	Strategic Risk	

The COBEP Audit Committee is comprised of the two non-executive Board directors and, amongst other things, has responsibility for reviewing the Bank’s internal financial controls and internal control and risk management systems.

Corporate Audit Services independently assess the effectiveness of the system of internal controls and risk management practises and report directly to the COBEP Audit Committee.

The Principal Managing Director (PMD) of COBEP has appointed a Chief Risk Officer, UK (CROUK) a member of the UK Leadership Team, who is responsible for:

- Overseeing the overall COBEP ERM program
- Chairing the Enterprise Risk Management Committee (ERMC) which is an advisory committee to the CROUK to assist them in fulfilling their role
- Aggregating risks and reporting COBEP’s risk profile to the Board and PMD

The corporate Enterprise Risk Management (ERM) Policy identifies eight risk categories under which all material risks to Capital One are organised. The eight risk categories enable more efficient aggregation of risks, provide a mechanism to discuss and express risk appetite and allow assignment of risk specialists for each category to support business area executives.

The following analysis summarises the approach to the eight risk categories.

Credit Risk

Credit risk is the risk of loss from an obligor's failure to meet the terms of any contract. Credit risk arises primarily from COBEP's retail lending activities. COBEP's policy is to manage its credit portfolio to achieve above hurdle rate risk adjusted returns, to operate within the credit risk appetite approved by the Board and to comply with all applicable laws and regulations pertaining to the extension of credit. COBEP is subject to the corporate Credit Policy which has been adopted by the COBEP Board.

The accountable executive and risk owner for credit risk within COBEP is the Chief Credit Officer (CCO). The CCO chairs and is supported by the UK Divisional Credit Committee (UKDCC). The UKDCC meets at least 6 times each year to consider and discuss information about COBEP's credit risk performance; the quality of the credit portfolio; external industry and economic factors and the monitoring of the credit governance environment. The UKDCC accredits new Credit Officers and recommends to the COBEP Board any changes to COBEP's lending strategy or COBEP Credit Policy.

Operational Risk

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

COBEP's policy is to maintain a well controlled and sustainable operating environment that assures processes and controls are managed with a degree of rigour commensurate with their risk, and to maintain adequate capital reserves to protect against unforeseen operational risk events.

Responsibilities for Operational Risk Management are governed primarily by the Operational Risk Management Policy. Business Area Heads have primary accountability for management of operational risk within their business areas. The CROUK is responsible for establishing risk management standards within COBEP aligned to the Operational Risk Management Policy and the governance and monitoring of operational risk at an aggregated level across COBEP.

The corporate Operational Risk Management team, in conjunction with Finance, run the corporate capital process to establish necessary operational risk capital levels to assure resiliency against extreme operational risk event scenarios (the Operational Risk Economic Capital (OREC) process). The COBEP Enterprise Risk Management team facilitate the capture of the operational risk structured scenarios to determine the likely frequency and severity of operational losses across COBEP.

Legal risk

Legal risk is the risk of financial loss from new and changed laws, interpretation of law, legal entity structure, and contracting. The risk of financial loss from litigation is explicitly excluded from this risk category and captured in Operational Risk.

COBEP's policy is to comply with existing laws and regulations, new and changing laws and regulations, and new legal interpretations. The policy is to comply with laws and regulatory oversight required by our legal entity structure and contract legally and in a manner in the best interest of our shareholders.

Responsibilities and reporting requirements are documented in the Legal Risk Policy. The CROUK is the accountable executive and risk steward for legal risk. The CROUK acts as counsel to ensure the provision of consultative support to UK business areas on all legal and regulatory issues.

The Legal Department monitors proposed and pending legislation and regulations and changes to legislation and regulations that affect COBEP. They also interpret existing legislation and regulations that are important to the businesses. Legal risk is controlled by applying legal expertise, accessing specialised outside counsel when needed, and leveraging broad organizational access. Quarterly monitoring by the General Counsel further reduces the likelihood of new or impending changes to laws or regulations for which Capital One is unprepared.

Compliance Risk

Compliance risk is the risk of financial loss due to regulatory fines or penalties, restriction or suspension of business, or cost of mandatory corrective action, incurred by not adhering to applicable laws, regulations, and supervisory guidance.

COBEP's policy is to comply with all applicable laws, rulings, regulations, and supervisory guidance that apply to the company. The company is heavily regulated by a number of regulatory agencies and as such is compelled to have robust, enterprise-wide processes to provide reasonable assurance that the company remains compliant and is readily able to demonstrate its compliance performance and record to others when requested to do so.

The accountable executive and risk owner for Compliance Risk is the CROUK who is supported and advised by the ERM and Compliance Committee.

Market Risk

COBEP's internal definition of market risk refers to interest rate risk and foreign exchange risk within the banking book and, as such, is distinct from the definition of market risk in BIPRU 7 which has been excluded due to COBEP's lack of a trading book. Market risk is defined as the risk posed to earnings or the economic value of equity resulting from changes in interest rates or foreign exchange rates (market rates).

The objective of COBEP's approach to market risk is that COBEP's earnings and value shall be primarily due to its core lending activities and actions are taken to reduce the exposure of the company to market risk.

COBEP classifies the GENPRU risk category of “Interest rate risk in the banking book” to the internal risk category of Market Risk. The accountable executive and risk owner is the Chief Financial Officer who is supported by the COBEP Asset Liability Committee (ALCO).

COBEP maintains a rigorous process around the quantification and reporting of market risk along with detailed procedures. This process is documented in the Asset Liability Management Policy (ALM Policy).

Strategic Risk

Strategic risk is the risk to earnings or capital of operating a business in a competitive environment. Strategic risk includes the impact of competitive and economic factors, as well as potential adverse consequences of major long-term investments and/or major long-term resource commitments.

Capital One monitors and mitigates the strategic risks to the business by creating and pursuing effective strategies and by monitoring the external environment for changes that could disrupt the strategy.

The accountable executive and risk owner for strategic risk is the Principal Managing Director. The Principal Managing Director is responsible for developing and executing strategic direction for the business.

Reputation Risk

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

COBEP is firmly committed to the active and thoughtful management of the reputation risk inherent in its business. A positive reputation enhances COBEP’s ability to successfully conduct critical business activities, such as funding its operations efficiently, maintaining a healthy market value, attracting and retaining talented associates, winning loyal customers, and obtaining regulatory approvals to implement Capital One’s strategic plan.

The accountable executive and risk owner for reputational risk is the CROUK and the Enterprise Risk Management Committee provides advice and counsel in carrying out this role.

Liquidity Risk

Liquidity risk is the risk that an institution will be unable to meet its obligations (including the withdrawal of retail deposit balances) as and when they fall due because of an inability to liquidate assets or obtain adequate funding.

The purpose of the ALM Policy is to ensure that COBEP can meet the following objectives, in order of priority:

- Obligations can be met as they fall due (to maintain solvency)
- The ability to fund the required level of seller’s interest needed under the various securitisation programs (to prevent early amortisation)
- Maintenance of Capital One’s reputation and franchise
- Ability to fund planned growth

The accountable executive and risk owner for liquidity risk is the Chief Financial Officer who is supported by the COBEP Asset Liability Committee (ALCO).

COBEP maintains a rigorous process around the quantification and reporting of liquidity risk along with detailed procedures. This process is documented in the ALM Policy. This policy also lays out COBEP's approach to managing the liquidity impacts of securitisation risk. Rigorous controls and reporting requirements ensure that COBEP mitigates, and is well prepared to deal with, the risk of securitised assets returning to its balance sheet.

3. Capital resources

There are no material restrictions or impediments to the movement of capital between the legal entities included within the solo consolidated group. The capital resources of the solo consolidated group at 31st December 2008 can be broken down as follows:

Tier 1 Capital	£MM
Gross	364.4
Deductions	-
Net	364.4
Tier 2 Capital	
Upper Tier 2	59.3
Lower Tier 2	33.0
Deductions	-
Net	92.3
Deductions from Tier 1 and 2	(61.0)
Total capital after deductions	395.7

The tier 1 capital relates to the permanent share capital issued by the company and the accumulated reserves. The upper tier 2 capital relates to undated subordinated debt and general loss provisions. The lower tier 2 capital relates to subordinated debt which matures in August 2015. Both the dated and undated subordinated loans incur interest based on the three month London inter-bank offer rate. The loans are denominated in Sterling and any claims in respect of them are subordinated to the claims of all other creditors of the Company.

The deduction from Tier 1 and 2 capital relates to cash that has been trapped to support the company's securitisation activities due to excess spread falling below pre-assigned trigger levels.

4. Capital Adequacy

COBEP employs an economic capital model (ECM) to quantify its risk-based capital needs. The ECM methodology is fully embedded in business processes, being used for pricing and investment decisions across the business.

The economic capital assessment and allocation process in Capital One is governed by the Asset Liability Management Policy, approved by the COFC and COBEP Boards, and formalised in various procedure documents. As part of this process, key capital ratios, drivers, and forecasts are generated monthly and reviewed by US & UK ALCO to ensure compliance.

A number of stress scenarios have been developed to aid COBEP's Capital and Funding Contingency Planning. The aim is to satisfy management that COBEP can maintain capital levels through a deep economic downturn, in accordance with the firm's risk appetite, once appropriate mitigating actions have been considered.

Stress testing is carried out over the three major risk types that management have identified as being most critical to the future stability of the business:

- Strategic Risk
- Credit Risk
- Operational Risk

A combination of management judgement and statistical modelling is used to determine the magnitude of each risk type, and therefore its impact on the Profit and Loss and Balance Sheet. This is an iterative process that is carried out on an annual basis as part of the development of COBEP's Capital Plan, following the production of the Annual Budget. It involves those members of the senior management team best placed to devise appropriate stress scenarios and recommend levers for mitigating them.

Once the impact of the scenario has been evaluated, appropriate mitigating actions are discussed by the same senior management team that agreed upon the individual stress events. These include changing business strategy, implementation of contingency plans and specific capital planning actions.

5. Credit Risk

For the purposes of its Pillar 1 calculations, COBEP has adopted the Standardised Approach for the calculation of the credit risk capital requirement.

For COBEP, credit risk is mainly associated with loans to customers (credit card receivables and personal loans), which receive a 75% risk-weighting, and any liquidity portfolio that is held. The risk weighting for the liquidity portfolio will generally be 20% due to counterparties that trades are settled with and the duration of the trades. COBEP uses Fitch ratings to identify the appropriate risk weighting to assign to each exposure in the liquidity portfolio.

Credit risk exposure and capital requirement at 31st December 2008 and the average exposure for the year:

Gross Credit Risk Exposure (£MM)	31 Dec 2008		2008
	Exposure	Capital Req'ment	Average Exposure
Central governments & central banks	0.3	-	0.7
Institutions	405.0	6.5	507.0
Corporates	8.8	0.4	1.5
Retail	1,202.8	72.1	1,144.3
Securitisation positions	33.4	2.0	33.1
Other items	295.6	23.6	260.9
	1,945.9	104.6	1,947.5

Residual maturity of credit risk exposures at 31st December 2008:

Residual maturity of credit risk exposures (£MM)	Up to 3 months	3 months to 1 year	1 year to 3 years	Over 3 years	Total
Central governments & central banks	0.3	-	-	-	0.3
Institutions	405.0	-	-	-	405.0
Corporates	8.8	-	-	-	8.8
Retail	1,136.4	33.9	32.5	0.0	1,202.8
Securitisation positions	33.4	-	-	-	33.4
Other items	295.6	-	-	-	295.6
	1,879.5	33.9	32.5	0.0	1,945.9

Breakdown of the liquidity portfolio by maturity and credit quality step:

Exposure to Institutions (£MM)	Maturity		Total
	<3 mths	>3 mths	
Credit Quality Step			
1	405.0	-	405.0
>1	-	-	-
	405.0	-	405.0

6. Operational Risk

For the purposes of its Pillar 1 calculations, COBEP has adopted the Alternative Standardised Approach for calculating the operational risk capital requirement for its retail banking business. This stipulates that the capital requirement should equate to:

$$\text{Capital requirement} = 3 \text{ year average outstandings} * 3.5\% * 12\%$$

The Operational Risk capital requirement throughout 2009 is calculated as follows:

Operational Risk Capital Requirement	£MM
2006 Outstandings	4,564.9
2007 Outstandings	4,019.4
2008 Outstandings	3,782.8
Average	4,122.4
Multiplied by 3.5%	144.3
Operational Risk Capital Requirement (@12%)	17.3

7. Interest rate risk

COBEP does not have a trading book but is still exposed to interest rate risk in the non-trading book. Four sources of interest rate risk have been identified for COBEP:

- Repricing Risk
- Yield Curve Risk
- Basis Risk
- Optionality

The most significant source of interest rate risk for COBEP is re-pricing risk being the risk arising from timing differences in the maturity and re-pricing of bank assets, liabilities and off balance sheet positions. As such COBEP's interest rate risk capital assessment for the non trading book considers Net Interest Income (NII) sensitivity to a 200bps instantaneous parallel interest rate movement. To generate an estimate more conservative than just a one-year NII estimate, interest rate risk capital is set to equal the cumulative loss of the worst 12 consecutive months over the next 60 months. COBEP's interest rate risk is calculated as the post tax earnings impact from this NII reduction.

8. Counterparty credit risk

Capital One limits exposure to counterparties to manage financial risks such as credit risk. Limits are carefully assigned based on the relative value and risk of each exposure.

The COBEP Board has adopted the COFC Credit Risk Management Policy. Under this policy, the responsibility for setting the framework for controlling counterparty credit risk across the whole Capital One group, including the methodology for setting maximum credit limits, is held by the COFC Board and this responsibility is then delegated to US ALCO. Responsibility for setting operational credit limits for each entity (including COBEP) within this framework is delegated to US Treasury in order that COFC's exposure to counterparties is managed holistically.

No transactions shall be consummated with counterparties for which a maximum credit exposure has not been established. To establish a maximum credit exposure, counterparties must go through the counterparty approval process, controlled in the US.

Maximum credit exposure to any counterparty shall be determined using either a combination of long-term and short-term unsecured debt ratings, or, an appropriate industry standard methodology for assessing counterparty creditworthiness. Maximum credit exposure for a counterparty may be determined based on the ratings of the counterparty's parent company.

Maximum credit exposure to any single counterparty shall be dependent upon the amount of total capital, and, short-term and long-term senior unsecured debt ratings of such counterparty.

The Vice President of Corporate Credit Management in the US is responsible for assessing the financial condition of counterparties on an ongoing basis to ensure counterparties continue to meet eligibility requirements and that limits remain consistent with policy. Such assessment may rely wholly or partly on the information obtained from Fitch IBCA, Standard & Poor's or Moody's Investors Service ("the Rating Agencies"), including published debt ratings, ratings outlooks and the credit watch list.

To the extent that published debt ratings are utilised in the assessment process, if a counterparty is placed on negative watch by the Rating Agency, the ratings of which are currently being relied upon with respect to that counterparty, COFC shall assume a one-notch downgrade and reduce the exposure limit to that counterparty in accordance with the policy.

Daily and monthly reporting of trading positions, including percentage utilisation of credit limits is provided to senior management and compliance is reported to COBEP ALCO. Any breaches of counterparty credit limits are reported by exception to the COBEP Audit Committee.

9. Loss provisions

A past due exposure is defined as the unsecured part of any item that is past due for more than 90 days in accordance with BIPRU 3.4.96. An impaired asset is defined as any asset that is currently delinquent.

The provision for loan losses is maintained at the amount estimated to be sufficient to absorb probable future losses, net of recoveries, inherent in the existing reported portfolio. Provisions made during the year are charged to the profit and loss account net of recoveries of amounts previously written off.

The level of provisions necessary is determined primarily based on a migration analysis of delinquent and current accounts. In evaluating the sufficiency of the provision for loan losses, management also takes into consideration the following factors: recent trends in delinquencies and write-offs; historical trends in loan volume; forecasting uncertainties and size of credit risks; the degree of risk inherent in the final composition of the loan portfolio; economic conditions; credit evaluations; and underwriting policies.

Credit card transactions suspected of being fraudulent are charged to the profit and loss account within 90 days of commencing an investigation.

Reconciliation of the movement in provisions over the year

Provisions for bad and doubtful debts	£MM
At 1st January 2008	172.3
Charge to the profit and loss account for the year	282.4
Amounts written off	(335.7)
Recoveries of advances previously written off	89.1
At 31st December 2008	208.1

No geographic distribution of retail exposures is provided because COBEP operates solely in the UK. This is in line with the approach to statutory reporting.

10. Securitisation

COBEP meets its funding requirements through a combination of credit card securitisation and unsecured affiliate borrowing. As such, credit card securitisation forms a significant part of the funding strategy for the business. The amount of funding generated by COBEP's securitisation activities at 31st December 2008 was £2,431 million.

The percentage of the securitised assets treated as on balance sheet from a credit risk perspective is based on the provisions of BIPRU 9.13, 'Securitisations of revolving exposures with early amortisation provisions'. The associated credit card receivables continue to be accounted for on balance sheet from a UK GAAP perspective.

COBEP does not engage in any other securitisation activities (synthetic or traditional) other than credit card securitisations.