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# Capital One Bank (Europe) plc

Report and Financial Statements

31st December 2004



**Registered in England:** Number 3879023
**Registered office:** 350 Euston Road,
London, NW1 3JJ

# DIRECTORS' REPORT

The Directors present their report and the financial statements of Capital One Bank (Europe) plc ('the Company') for the year ended 31st December 2004.

## Principal activity and review of business

The Company provides a range of banking, financial and related services in Europe, principally in the UK.

Loans and advances to customers amounted to £4,159.7 million as at 31st December 2004 (2003: £3,099.6 million). The Company is ultimately owned by Capital One Financial Corporation ('the Corporation'). The Corporation started as an independent company in 1995, and has become a top ten credit card issuer in the United States with a global customer base of 48.6 million (2003: 47.0 million) and managed loans totalling $79.9 billion (2003: $71.2 billion). The Corporation's profit after tax for the year ended 31st December 2004 was $1.5 billion (2003: $1.1 billion).

## Results and dividends

The profit for the year, after taxation, amounted to £40.9 million (2003: £36.3 million). The Directors do not recommend payment of a dividend on the ordinary shares. The Directors consider the level of business and the prospects of the Company to be satisfactory.

## Post balance sheet events

On 4th January 2005, the Company acquired 100% of the share capital of HFS Group Limited for £65.0 million. £22.7 million of the consideration was utilised to repay existing debts of HFS Group Limited.

## Directors

The Directors who served in the year were as follows:

| | |
|---|---|
| Executive Directors | NW Morris (resigned 30th April 2004)<br>FS Brownlee (Principal Managing Director)<br>LA Klane (Chairman)<br>G Perlin (appointed 1st May 2004) |
| Non-Executive Directors | AHC Broadbent<br>TL Jones |

On 1st January 2004 LA Klane was appointed as Chairman to replace NW Morris.

## Directors' interests

The Directors' interests in share options in the Corporation, the ultimate parent undertaking, are disclosed in Directors' emoluments and transactions (Note 30).

## Associate involvement

The Company places considerable value on the involvement of the people it employs ('associates') and continues to keep them informed on matters affecting them as associates and on the various factors affecting the performance of the Capital One Group. This is achieved through formal and informal meetings, including an associate representation body, a series of all-associate meetings, company magazines and other corporate communications. Many associates have a financial stake in the success of the Group through the stock purchase and long term incentive programs in the Corporation.

## DIRECTORS' REPORT (continued)

### Employment of disabled persons

The Company gives full and fair consideration to applications for employment from disabled persons, having regard to their particular aptitudes and abilities. It is the Company's policy to provide ongoing employment and appropriate retraining to associates who become disabled, wherever practicable, and to provide training and career development to disabled associates.

### Charitable Donations

During the year the Company made charitable donations of £134,000 (2003: £213,000) to a wide range of beneficiaries. No political donations were made (2003: £nil).

### Supplier payment policy

Standard payment terms are by the end of the month following the month of invoice, unless individual contract terms have been agreed. As at 31st December 2004, the Company had an average of 23 days' purchases outstanding in trade creditors (2003: 2 days).

**Signed by order of the Board**

**VG Mitchell,**
**Secretary,**
**4th March 2005**

## STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the Directors to prepare financial statements for each financial period which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

# INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF CAPITAL ONE BANK (EUROPE) PLC

We have audited the Company's financial statements for the year ended 31st December 2004 which comprise the Profit and Loss Account, Balance Sheet, Statement of Total Recognised Gains and Losses, Reconciliation of Shareholders' Funds and the related notes 1 to 32. These financial statements have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of directors and auditors**

As described in the Statement of Directors' Responsibilities the Company's directors are responsible for the preparation of the financial statements in accordance with United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Company is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

**Basis of audit opinion**

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**Opinion**

In our opinion the financial statements give a true and fair view of the state of affairs of the Company as at 31st December 2004 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

**Ernst & Young LLP**
**Registered Auditor**
**London**
**4th March 2005**

## PROFIT AND LOSS ACCOUNT

For the year ended 31st December 2004

| | Notes | 2004 £'000 | 2003 £'000 |
|---|---|---|---|
| **INTEREST RECEIVABLE** | | | |
| Interest receivable and similar income arising from debt securities | | 5,187 | 3,872 |
| Other interest receivable and similar income | | 422,228 | 316,792 |
| **INTEREST PAYABLE** | | (189,996) | (138,312) |
| **NET INTEREST INCOME** | | 237,419 | 182,352 |
| Income from equity shares in group undertakings | | 16 | - |
| Fees and commissions receivable | | 312,819 | 250,827 |
| Fees and commissions payable | | (2,404) | (3,066) |
| Other operating income | | 2,311 | 1,843 |
| **TOTAL OPERATING INCOME** | | 550,161 | 431,956 |
| Administrative expenses | 2 | (348,658) | (299,511) |
| Depreciation | 10 | (6,315) | (4,239) |
| Provisions for bad and doubtful debts | 7 | (155,834) | (113,047) |
| **OPERATING PROFIT** | | 39,354 | 15,159 |
| Profit on termination of operation | 3 | 16,600 | - |
| **PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION** | | 55,954 | 15,159 |
| Tax (charge) credit on ordinary activities | 4 | (15,030) | 21,114 |
| **RETAINED PROFIT FOR THE YEAR** | | 40,924 | 36,273 |

## STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

For the year ended 31st December 2004

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **RETAINED PROFIT FOR THE YEAR** | 40,924 | 36,273 |
| Currency translation differences | 1,000 | (938) |
| **TOTAL RECOGNISED PROFIT FOR THE YEAR** | 41,924 | 35,335 |

Other than the profit on termination of operations, there are no material amounts included in the above results relating to discontinued operations.

## BALANCE SHEET
As at 31st December 2004

| | Notes | 2004 £'000 | 2003 £'000 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and balances at central banks | | 1,103 | 887 |
| Loans and advances to banks | 5 | 301,525 | 205,130 |
| Loans and advances to customers | 6 | 4,159,696 | 3,099,576 |
| Debt securities | 8 | 80,000 | 220,000 |
| Investments | 9 | 100 | - |
| Tangible fixed assets | 10 | 10,067 | 9,953 |
| Other assets | 11 | 108,461 | 103,037 |
| Prepayments and accrued income | | 27,208 | 20,322 |
| **Total Assets** | | 4,688,160 | 3,658,905 |
| **LIABILITIES** | | | |
| Deposits by banks | 12 | 3,688 | 35,342 |
| Customer accounts | 13 | 1,187,061 | 911,342 |
| Debt securities in issue | 14 | 2,296,788 | 1,842,334 |
| Other liabilities | 15 | 739,917 | 490,689 |
| Accruals and deferred income | 16 | 71,381 | 64,930 |
| Provisions for liabilities and charges | 17 | 8,463 | 8,330 |
| Subordinated liabilities | 18 | 73,000 | 73,000 |
| **Total Liabilities** | | 4,380,298 | 3,425,967 |
| **TOTAL ASSETS LESS LIABILITIES** | | 307,862 | 232,938 |
| **CAPITAL AND RESERVES** | | | |
| Called up share capital | 19 | 329,913 | 296,913 |
| Profit and loss account | 20 | (22,051) | (63,975) |
| **Equity Shareholders' Funds** | | 307,862 | 232,938 |

These financial statements were approved by the Board of Directors on 4th March 2005 and signed on its behalf by:

**F S Brownlee**
**Principal Managing Director**

# NOTES TO THE FINANCIAL STATEMENTS

As at 31st December 2004

## 1. ACCOUNTING POLICIES

### Accounting convention

The financial statements have been prepared under the historical cost convention and in accordance with the special provisions of Part VII Chapter II of the Companies Act 1985 relating to banking companies, applicable accounting standards and the following Statements of Recommended Practice issued by the British Bankers' Association: Advances; Contingent Liabilities and Commitments; Derivatives; Securities; and Segmental Reporting.

The company has taken advantage of the exemption from preparing consolidated financial statements afforded by Section 228 of the Companies Act 1985 because it is a wholly owned subsidiary of Capital One Holdings Limited which prepares consolidated financial statements which are publicly available. A cash flow statement has not been included in these financial statements as allowed by Financial Reporting Standard ('FRS') 1, Cash Flow Statements (revised). A consolidated cash flow statement is included in the consolidated financial statements of the Corporation.

### Loans and advances to customers

The Company recognises finance charges and fee income on loans according to the contractual provisions of the credit agreements. When, based on historic performance of the portfolio, payment in full of finance charge and fee income is not expected, the estimated uncollectable portion of previously accrued amounts are reversed against current period income. The Company writes off credit card loans at 180 days past due.

Certain loans and advances to customers have been securitised. Where there is no significant change either in the Company's rights or benefits to those assets, or in the Company's exposure to the risks inherent in these benefits, they continue to be included on a gross basis in accordance with FRS 5, Reporting the Substance of Transactions.

### Provisions for bad and doubtful debts

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 levels of specific and general provisions necessary are 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.

### Debt Securities

Securities intended for use on a continuing basis in the Company's activities are classified as investment securities. Such securities are stated at cost less provision for any permanent diminution in value. In those rare instances where an investment security is sold prior to maturity, profits and losses are recognised when realised.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

# 1. ACCOUNTING POLICIES (continued)

### Derivatives

Derivatives are entered into for specifically designated hedging purposes. Gains and losses arising from these derivative transactions are recognised in accordance with the accounting treatment of the underlying transactions.

### Tangible fixed assets

Tangible fixed assets are stated at cost less depreciation. Depreciation is charged so as to write off the cost of fixed assets, less their estimated residual values, on a straight line basis over their expected useful economic lives, being 3 years for computer equipment, 3-10 years for fixtures, fittings and furniture, and the shorter of the remaining leasehold term or 5 years for leasehold improvements.

### Leased assets

Rentals payable under operating leases are accounted for on a straight-line basis over the period of the lease.

### Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction or at the contracted rate if the transaction is covered by a forward foreign currency contract. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date or if appropriate at the forward contract rate. All differences are taken to the profit and loss account.

The profit and loss items of overseas branches are recorded at the rate of exchange ruling on the date of the transaction. The balance sheet items of overseas branches are recorded at the rate ruling at the balance sheet date. The exchange difference arising from the translation of the opening net assets of the overseas branches is taken directly to reserves.

### Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more or a right to pay less tax. Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits. Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

### Pension costs

The Company participates in the Capital One Group Personal Pension Scheme, a defined contribution scheme which is operated by an independent fund manager. Contributions are charged to the profit and loss account as they become payable in accordance with the rules of the scheme. The assets of the scheme are held separately from those of the Company.

## NOTES TO THE FINANCIAL STATEMENTS (continued)
As at 31st December 2004

## 2. ADMINISTRATIVE EXPENSES

Operating profit is stated after charging:

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Staff costs:** | | |
| Wages and salaries | 36,426 | 32,333 |
| Social security costs | 4,428 | 4,361 |
| Pension costs | 1,650 | 1,494 |
| | 42,504 | 38,188 |
| **Operating lease rentals:** | | |
| Property | 7,291 | 6,775 |
| Equipment | 16 | 368 |
| **Auditors' remuneration:** | | |
| Audit fees | 210 | 175 |
| Non-audit fees | 358 | 498 |

The average number of associates employed by the Company during the year was 1,031 (2003: 746), all of whom were employed in management and administration.

## 3. PROFIT ON TERMINATION OF OPERATION

The exceptional profit before tax of £16.6 million (£11.6 million after taxation) relates to the termination of the Company's operations in France and sale of related assets. This comprises a gain on sale of assets, net of related costs, of £23.1 million, and further costs for closure of the operations of £6.5 million. The customer accounts in relation to this termination were sold on 1st October 2004.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 4. TAXATION

### (a) Tax (charge) credit on ordinary activities

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Current tax** | | |
| United Kingdom corporation tax | (9,789) | 4,292 |
| Adjustments in respect of previous periods | - | 949 |
| Total current tax | (9,789) | 5,241 |
| **Deferred tax** | | |
| Origination and reversal of timing differences | (5,182) | (9,055) |
| Adjustment to estimated recoverable deferred tax asset arising in previous periods | (59) | 24,928 |
| Total deferred tax | (5,241) | 15,873 |
| **Total (charge) credit on ordinary activities** | (15,030) | 21,114 |

Tax losses have been surrendered to other group companies for which payment will be received at a rate of 30 pence for each £1 surrendered.

### (b) Factors affecting current tax charge

The tax charge for the year is based on a UK corporation tax rate of 30% (2003: 30%). The differences between the tax assessed for the year and the standard rate of corporation tax in the UK, are explained as follows:

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Profit on ordinary activities before taxation** | 55,954 | 15,159 |
| **30% of profit on ordinary activities** | (16,786) | (4,548) |
| **Effects of:** | | |
| **Changes in timing differences** | | |
| *Capital allowances for the year less than depreciation* | (354) | (71) |
| Movements in other timing differences including movements in general provision for bad and doubtful debts | (671) | 10,147 |
| **Deductible expenses not charged in accounts** | 2,013 | - |
| **Expenses not deductible for tax purposes** | (198) | (215) |
| **Tax losses *not relieved* within group** | - | (1,021) |
| **Utilisation of tax losses** | 6,207 | - |
| **Adjustment in respect of previous periods** | - | 949 |
| | (9,789) | 5,241 |

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 4. TAXATION (continued)

### (c) Deferred Taxation

| | 2004 £'000 Provided | 2004 £'000 Unprovided | 2003 £'000 Provided | 2003 £'000 Unprovided |
|---|---|---|---|---|
| Decelerated capital allowances | 1,480 | - | 1,185 | - |
| Tax losses carried forward | - | - | 6,207 | - |
| General provision for bad and doubtful debts | 9,152 | - | 8,481 | - |
| | 10,632 | - | 15,873 | - |

The Directors consider that, recognising current profitability and future forecasts, it is more likely than not that there will be sustainable taxable profits from which the future reversal of the underlying timing differences can be deducted.

| Movement in deferred tax asset | £'000 |
|---|---|
| **1st January 2004** | 15,873 |
| Deferred tax charge in the profit and loss account | (5,241) |
| **At 31st December 2004** | 10,632 |

## 5. LOANS AND ADVANCES TO BANKS

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| Repayable on demand or at short notice | 301,525 | 205,130 |

## 6. LOANS AND ADVANCES TO CUSTOMERS

| (a) Loans and advances to customers | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Repayable on demand or at short notice** | 4,026,223 | 2,969,657 |
| **Other loans and advances to customers by remaining maturity:** | | |
| 3 months or less, excluding on demand or short notice | 17,147 | 20,443 |
| 1 year or less but over 3 months | 50,865 | 80,945 |
| 5 years or less but over 1 year | 171,259 | 110,700 |
| Over 5 years | - | - |
| | 4,265,494 | 3,181,745 |
| **Provisions for bad and doubtful debts** | (105,798) | (82,169) |
| | 4,159,696 | 3,099,576 |

There is no fixed term for repayment on credit card loans other than the requirement to pay a minimum monthly amount. For the purposes of the above table, these loans are classified as repayable on demand or at short notice.

## NOTES TO THE FINANCIAL STATEMENTS (continued)
As at 31st December 2004

## 6. LOANS AND ADVANCES TO CUSTOMERS (continued)

Interest and fees are not suspended on individual customers' accounts but provisions are charged to the profit and loss account, based on a statistical model. The principal provision is allocated to specific accounts based on the delinquency of the principal balance. The specific provision amount of £75.3 million (2003: £53.9 million) provides for 100% of those accounts in the latter stages of delinquency.

### (b) Securitisation and loan transfers

During 2004 the Company sold £1,066 million (2003: £1,028 million) of its credit card receivables to a trust vehicle created for the purpose of asset backed securitisations. The noteholders in these securitisations have a proportionate interest in each balance in the portfolio of securitised receivables and as at 31st December 2004 the value of this interest was £2,303 million (2003: £1,847 million). The funding giving rise to the noteholders' interest is included within Debt Securities in Issue (Note 14). The interest payable on the loan notes in the year was £105.7 million (2003: £62.6 million). These securitisations do not qualify for linked presentation under FRS 5, Reporting the Substance of Transactions, and the total portfolio is therefore included within Loans and Advances to Customers.

## 7. PROVISIONS FOR BAD AND DOUBTFUL DEBTS

| **2004** | **General provision £'000** | **Specific provision £'000** | **Total £'000** |
|---|---|---|---|
| **At 1st January 2004** | 28,271 | 53,898 | 82,169 |
| Charge to the profit and loss account for the year | 7,788 | 148,046 | 155,834 |
| Adjustments due to exchange rate movements | (27) | (259) | (286) |
| Amounts written off | - | (169,585) | (169,585) |
| Recoveries of advances previously written off | - | 45,614 | 45,614 |
| Termination of operations | (5,526) | (2,422) | (7,948) |
| **At 31st December 2004** | 30,506 | 75,292 | 105,798 |

| **2003** | **General provision £'000** | **Specific provision £'000** | **Total £'000** |
|---|---|---|---|
| **At 1st January 2003** | 34,245 | 37,964 | 72,209 |
| (Credit) charge to the profit and loss account for the year | (5,937) | 118,984 | 113,047 |
| Adjustments due to exchange rate movements | (37) | 98 | 61 |
| Amounts written off | - | (137,312) | (137,312) |
| Recoveries of advances previously written off | - | 34,164 | 34,164 |
| **At 31st December 2003** | 28,271 | 53,898 | 82,169 |

All of the above provisions relate to loans and advances to customers.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 8. DEBT SECURITIES

| Unlisted investment securities due within one year | Cost and carrying value £'000 |
|---|---|
| **Bank and building society certificates of deposit** | |
| **At 1st January 2004** | 220,000 |
| Additions | 759,001 |
| Disposals and maturities | (899,001) |
| **At 31st December 2004** | 80,000 |

## 9. INVESTMENTS

| 2004 | Equity Investments £'000 | Capital Contribution £'000 | Total Investment £'000 |
|---|---|---|---|
| **At 1st January 2004** | - | - | - |
| Cost of additional equity investment | - | - | - |
| Capital contribution | - | 100 | 100 |
| **At 31st December 2004** | - | 100 | 100 |

The Company holds investments in the following subsidiary undertakings, both of which were incorporated during the year:

| | Country of Incorporation | Principal activity |
|---|---|---|
| Capital One Securities Limited | England and Wales | Investment company |
| Capital One Overseas Limited | Cayman Islands | Investment company |

Capital One Securities Limited is limited by guarantee and is wholly owned by the Company. Capital One Overseas Limited has two classes of share capital with equal nominal value, of which the Company owns 40% of its Class A shares and 100% of its Class B shares. The remaining 60% of its Class A shares are owned by Capital One Securities Limited, and therefore indirectly by the Company also.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 10. TANGIBLE FIXED ASSETS

| | Leasehold *improvements* £'000 | Equipment, fixtures & fittings £'000 | Total £'000 |
|---|---|---|---|
| **Cost** | | | |
| **At 1st January 2004** | 1,757 | 15,348 | 17,105 |
| Additions | 7 | 8,020 | 8,027 |
| Disposals | (107) | (2,792) | (2,899) |
| Exchange adjustments | (1) | (70) | (71) |
| **At 31st December 2004** | 1,656 | 20,506 | 22,162 |
| **Depreciation** | | | |
| **At 1st January 2004** | (245) | (6,907) | (7,152) |
| Charge for the year | (339) | (5,976) | (6,315) |
| Disposals | 29 | 1,290 | 1,319 |
| Exchange adjustments | - | 53 | 53 |
| **At 31st December 2004** | (555) | (11,540) | (12,095) |
| **Net book value** | | | |
| **At 31st December 2004** | 1,101 | 8,966 | 10,067 |
| **Net book value** | | | |
| **At 31st December 2003** | 1,512 | 8,441 | 9,953 |

Future capital expenditure contracted but not provided in the financial statements was £0.5 million (2003: £0.7 million).

## 11. OTHER ASSETS

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Due from the trust** (Note 6b) | 62,688 | 47,208 |
| **Amounts owed by group undertakings** | 2,732 | 21,236 |
| **Corporation tax payments on account** | 5,111 | 4,000 |
| **Deferred taxation** (Note 4) | 10,632 | 15,873 |
| **Other assets** | 27,298 | 14,720 |
| | 108,461 | 103,037 |

## NOTES TO THE FINANCIAL STATEMENTS (continued)

*As at 31st December 2004*

### 12. DEPOSITS BY BANKS

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Repayable on demand** | 3,688 | 35,239 |
| **With agreed maturity dates or periods of notice, by remaining maturity:** | | |
| 3 months or less, excluding on demand | - | 103 |
| | 3,688 | 35,342 |

### 13. CUSTOMER ACCOUNTS

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Repayable on demand** | 349,029 | 114,132 |
| **With agreed maturity dates or periods of notice, by remaining maturity:** | | |
| 3 months or less, excluding on demand | 54,701 | 213,589 |
| 1 year or less but over 3 months | 206,318 | 105,766 |
| 5 years or less but over 1 year | 577,013 | 477,855 |
| | 1,187,061 | 911,342 |

### 14. DEBT SECURITIES IN ISSUE

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Medium term notes** | | |
| within one year | - | 418,000 |
| 5 years or less but over 2 years | 1,376,467 | 1,178,565 |
| over 5 years | 927,014 | 250,000 |
| | 2,303,481 | 1,846,565 |
| Unamortised issue costs | (6,693) | (4,231) |
| | 2,296,788 | 1,842,334 |

The above funding was raised from the securitisation of credit card receivables (Note 6b).

### 15. OTHER LIABILITIES

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Trade creditors** | 7,127 | 538 |
| **Amounts owed to group undertakings** | 694,765 | 473,999 |
| **Other taxation and social security** | 7,719 | 6,446 |
| **Other liabilities** | 30,306 | 9,706 |
| | 739,917 | 490,689 |

## NOTES TO THE FINANCIAL STATEMENTS *(continued)*
As at 31st December 2004

## 16. ACCRUALS AND DEFERRED INCOME

| | 2004<br>£'000 | 2003<br>£'000 |
|---|---|---|
| **Accruals** | 52,274 | 49,540 |
| **Deferred income** | 19,107 | 15,390 |
| | 71,381 | 64,930 |

Accruals include £1.0 million relating to contributions outstanding at 31st December 2004 (2003: £0.8 million) to the Capital One Group Personal Pension Scheme, arising as a result of the normal monthly investment cycle.

## 17. PROVISIONS FOR LIABILITIES AND CHARGES

| | Provisions for liabilities and charges<br>£'000 |
|---|---|
| **At 1st January 2004** | 8,330 |
| Additional provisions made in the year | 4,628 |
| Provisions utilised in the year | (3,627) |
| Unused provisions reversed in the year | (868) |
| **At 31st December 2004** | 8,463 |

The provisions of £8.5 million (2003: £8.3 million) relate to various claims and potential claims against the Company. The claims are at various stages and accordingly the Directors cannot determine the timing of use of the provision and cannot disclose other information because such disclosure might be prejudicial to the outcome.

## 18. SUBORDINATED LIABILITIES

| | 2004<br>£'000 | 2003<br>£'000 |
|---|---|---|
| **Undated loan capital** | | |
| Perpetual subordinated loan | 40,000 | 40,000 |
| **Dated loan capital** | | |
| Subordinated loan 2010 | 33,000 | 33,000 |
| | 73,000 | 73,000 |

The loan capital is denominated in Sterling and any claims in respect of it are subordinated to the claims of all other creditors of the Company. The subordinated liabilities are redeemable at the option of the Company provided certain conditions are met.

Both the perpetual subordinated loan and the subordinated loan 2010 are interest-free. All subordinated liabilities were issued to other group undertakings. The subordinated loan interest charged during the year was £nil (2003: £0.1 million). The prior year interest arose on a loan which was only in existence for part of 2003.

## NOTES TO THE FINANCIAL STATEMENTS (continued)
As at 31st December 2004

## 19. CALLED UP SHARE CAPITAL

| | 2004 Number of shares | 2004 £'000 | 2003 Number of shares | 2003 £'000 |
|---|---|---|---|---|
| **Authorised** | | | | |
| Ordinary shares of £1 each | 350,000,000 | 350,000 | 350,000,000 | 350,000 |
| **Issued, allotted and fully paid** | | | | |
| Ordinary shares of £1 each | 329,913,249 | 329,913 | 296,913,249 | 296,913 |

On 22nd December 2004, the Company issued 33,000,000 £1 ordinary shares to Capital One Holdings Limited at par for cash.

## 20. PROFIT AND LOSS ACCOUNT

| | Profit and loss account £'000 |
|---|---|
| **At 1st January 2004** | (63,975) |
| Retained profit for the year | 40,924 |
| Exchange adjustments | 1,000 |
| **At 31st December 2004** | (22,051) |

## 21. POST BALANCE SHEET EVENTS

*On 4th January 2005, the Company acquired 100% of the share capital of HFS Group Limited for* £65.0 million. £22.7 million of the consideration was utilised to repay existing debts of HFS Group Limited.

## 22. RECONCILIATION OF MOVEMENTS IN EQUITY SHAREHOLDERS' FUNDS

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| Profit for the financial year | 40,924 | 36,273 |
| Currency translation differences | 1,000 | (938) |
| | 41,924 | 35,335 |
| Issue of ordinary shares | 33,000 | 25,000 |
| Net addition to equity shareholders' funds | 74,924 | 60,335 |
| **Opening equity shareholders' funds** | 232,938 | 172,603 |
| **Closing equity shareholders' funds** | 307,862 | 232,938 |

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 23. TREASURY POLICY AND RISK MANAGEMENT

The Company's financial instruments, other than derivatives, comprise borrowings to finance its operations, loans and advances to banks and customers, and customer accounts which arise directly from the Company's operations. All short-term debtors and creditors have been included in the following disclosures.

Derivative financial instruments are held by the Company for non-trading purposes only to manage risks arising from its operations and sources of finance, including securitisation transactions in non-sterling currencies. The derivatives used for this purpose are principally foreign exchange swaps and interest rate swaps.

The main risks arising from the Company's financial instruments are market risk, liquidity risk and credit risk. The Board of Directors approves policy and limits with respect to these risks, and has delegated its monitoring and control responsibilities to the Asset and Liability Committee ('ALCO') for market risk, liquidity and wholesale credit matters, and to the European Credit Committee for retail credit matters. Any material change in the nature of the Company's use of derivatives is subject to Board approval.

**Market risk**

Market risk is the potential adverse change in Company income or the value of the Company's net worth resulting from movements in interest rates and exchange rates. The Company's exposure to market risk is governed by policies approved by the Board of Directors. These policies set out the nature of the risk which may be taken, the types of financial instrument which may be used and the ways in which risk is controlled.

Overall risk limits have been assigned by ALCO, which monitors compliance with the limits. The Company measures and monitors market risk by applying a series of stress tests to measure the Company's sensitivity to changes in interest rates and by generating a distribution of outcomes based on foreign exchange rate paths which are generated from an industry-accepted term structure model. Market risk is subject to independent measurement, reporting and control. The Company considers that the two most significant aspects of market risk it faces are exchange rate risk and interest rate risk.

Exchange rate risk arises due to the impact of foreign exchange movements on transactions and wholesale funding activities conducted in the Euro and the translation of the results and net assets of the Company's European operations. The exposure is managed by natural hedging techniques such as funding assets with liabilities in the same currency or by the use of foreign exchange swaps.

Interest rate risk arises from mismatches between the Company's fixed and variable rate funding and assets. The Company manages and mitigates its interest rate sensitivity through several techniques which include, but are not limited to, changing the maturity, repricing and distribution of assets and liabilities, and by entering into interest rate swaps.

The table below shows the actual on-balance sheet amounts and summarises the re-pricing mismatch as at 31st December 2004. For the major categories of asset and liability, this gap table shows the volumes maturing in selected maturity bands.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 23. TREASURY POLICY AND RISK MANAGEMENT (continued)

| **Interest rate re-pricing as at 31st December 2004** | **Not more than 3 months £'m** | **Over 3 months but not more than 6 months £'m** | **Over 6 months but not more than 1 year £'m** | **Over 1 year but not more than 5 years £'m** | **Over 5 years £'m** | **Non-interest bearing £'m** | **Total £'m** |
|---|---|---|---|---|---|---|---|
| **Assets:** | | | | | | | |
| Loans & advances to banks | 302 | - | - | - | - | - | 302 |
| Loans & advances to customers | 3,217 | 218 | 223 | 238 | 264 | - | 4,160 |
| Debt securities | 80 | - | - | - | - | - | 80 |
| Other assets | - | - | - | - | - | 146 | 146 |
| Total Assets | 3,599 | 218 | 223 | 238 | 264 | 146 | 4,688 |
| **Liabilities:** | | | | | | | |
| Deposits by banks | 4 | - | - | - | - | - | 4 |
| Customer accounts | 403 | 64 | 143 | 577 | - | - | 1,187 |
| Debt securities in issue | 2,082 | - | - | - | 215 | - | 2,297 |
| Other liabilities | 320 | - | - | 339 | - | 160 | 819 |
| Subordinated liabilities | - | - | - | - | - | 73 | 73 |
| Equity shareholders' funds | - | - | - | - | - | 308 | 308 |
| Total Liabilities | 2,809 | 64 | 143 | 916 | 215 | 541 | 4,688 |
| **Balance sheet sensitivity gap** | 790 | 154 | 80 | (678) | 49 | (395) | - |
| **Off-balance sheet items** | (215) | - | - | - | 215 | - | - |
| **Interest rate sensitivity gap** | 575 | 154 | 80 | (678) | 264 | (395) | - |
| **Cumulative gap** | 575 | 729 | 809 | 131 | 395 | - | - |

| **Interest rate re-pricing as at 31st December 2003** | **Not more than 3 months £'m** | **Over 3 months but not more than 6 months £'m** | **Over 6 months but not more than 1 year £'m** | **Over 1 year but not more than 5 years £'m** | **Over 5 years £'m** | **Non-interest bearing £'m** | **Total £'m** |
|---|---|---|---|---|---|---|---|
| **Assets:** | | | | | | | |
| Loans & advances to banks | 205 | - | - | - | - | - | 205 |
| Loans & advances to customers | 2,174 | 183 | 81 | 70 | 592 | - | 3,100 |
| Debt securities | 220 | - | - | - | - | - | 220 |
| Other assets | 14 | - | - | - | - | 120 | 134 |
| Total Assets | 2,613 | 183 | 81 | 70 | 592 | 120 | 3,659 |
| **Liabilities:** | | | | | | | |
| Deposits by banks | 25 | - | - | 10 | - | - | 35 |
| Customer accounts | 328 | 34 | 71 | 478 | - | - | 911 |
| Debt securities in issue | 1,627 | - | - | - | 215 | - | 1,842 |
| Other liabilities | 101 | - | - | 350 | - | 114 | 565 |
| Subordinated liabilities | - | - | - | - | - | 73 | 73 |
| Equity shareholders' funds | - | - | - | - | - | 233 | 233 |
| Total Liabilities | 2,081 | 34 | 71 | 838 | 215 | 420 | 3,659 |
| **Balance sheet sensitivity gap** | 532 | 149 | 10 | (768) | 377 | (300) | - |
| **Off-balance sheet items** | (215) | - | - | - | 215 | - | - |
| **Interest rate sensitivity gap** | 317 | 149 | 10 | (768) | 592 | (300) | - |
| **Cumulative gap** | 317 | 466 | 476 | (292) | 300 | - | - |

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 23. TREASURY POLICY AND RISK MANAGEMENT (continued)

### Liquidity risk

It is Company policy to ensure that resources are always available to meet the Company's obligations arising from the withdrawal of customer deposits and asset expansion. The development, implementation and monitoring of this policy is the responsibility of ALCO. The exposure is managed by ensuring that the maturity profile of liabilities avoids a concentration of funding requirements at any one time or from any one source. The Company also holds a liquid assets portfolio and has access to committed facilities. Daily cash needs are met by borrowings from other group undertakings and general overdraft and bank borrowing facilities.

### Credit risk

Credit risk arises primarily from loans and advances to customers and banks. The quality of all retail lending is monitored and measured using portfolio management tools and proactive quality assurance measures. These are supplemented with credit risk related management information. The arrears management process ensures that the impact of delinquent loans on the Company's performance is minimised. Wholesale lending and counterparty credit exposure is tightly controlled with specific limits applied to counterparties depending on an internal assessment of their credit quality. Any investment activity undertaken by the Company is limited to instruments authorised by ALCO.

### Derivatives

A derivative is an off-balance sheet agreement which defines certain financial rights and obligations which are contractually linked to interest rates, exchange rates or other market prices. Derivatives allow the Company to modify the re-pricing or maturity characteristics of assets and liabilities, to manage market risk and to limit counterparty exposures in an efficient and cost effective manner. As such, they are an important element of risk management.

Underlying principal amounts are used to express the volume of derivative transactions, but the amounts potentially subject to credit risk are much smaller. Replacement cost provides a better indication of the credit risk exposures facing a bank. Replacement cost is the gross cost of replacing all contracts that have a positive fair value.

The fair values of derivatives fluctuate as market rates rise and fall just as the fair values of on-balance sheet assets and liabilities fluctuate. Since the derivatives are purchased or sold as hedges of balance sheet items, the appreciation or depreciation in fair value of the derivatives, as market rates change, will generally be offset by the unrealised appreciation or depreciation of the hedged on-balance sheet item.

As at 31st December 2004, the Company had exchange rate contracts, due within one year, with an underlying principal amount of £nil (2003: £96.6 million), a book value of £nil (2003: £nil) and a fair value of £nil (2003: £(0.4) million). As at 31st December 2004, the Company had interest rate swap contracts, which mature after more than five years, with an underlying principal amount of £215.0 million (2003: £215.0 million), a book value of £nil (2003: £nil) and a fair value of £(1.7) million (2003: £(2.5) million). During 2004 the interest rate swap was bifurcated, such that part of the obligations and benefits of the swap contract are now held by a wholly-owned subsidiary of the Company. The overall interest rate risk for the Company as a result of the bifurcation remains unchanged.

Gains and losses on instruments used for hedging are recognised in line with the underlying items which are being hedged. The unrecognised net loss on these instruments as at 31st December 2004 was £(1.7) million (2003: £(2.9) million).

The loss expected to be recognised in the year to 31st December 2005 is £nil. The loss recognised in the year to 31st December 2004 in respect of previous years was £(0.4) million and the gain arising in the year to 31st December 2004, which was not recognised in the current year, was £0.8 million.

## NOTES TO THE FINANCIAL STATEMENTS (continued)
As at 31st December 2004

## 24. STRUCTURAL CURRENCY EXPOSURES

The Company's structural currency exposures were:

| | Functional currency of the operation involved | Net investments in overseas operations | Borrowings taken out in the functional currencies of the overseas operations in order to hedge the net investments in such operations | Remaining structural currency exposures |
|---|---|---|---|---|
| | | £'000 | £'000 | £'000 |
| 31st December 2004 | Euro | - | - | - |
| 31st December 2003 | Euro | (16,078) | - | (16,078) |

During 2004, the Company disposed of its only operations that gave rise to structural currency exposures (Note 3). The structural currency of this operation was the Euro and, as the currency in which the bank prepares its financial statements is Sterling, assets and liabilities held by this operation gave rise to currency exposures up to the point of termination. Gains and losses related to these exposures were recognised in the Statement of Total Recognised Gains and Losses.

## 25. FUNCTIONAL CURRENCY OF ASSETS AND LIABILITIES

The monetary assets and liabilities of the Company that are not denominated in the operating currency of the operating unit involved as at 31st December 2004 were as follows:

| | Net foreign currency monetary assets/(liabilities) | | | | |
|---|---|---|---|---|---|
| **Functional currency of operation** | **Sterling** | **Euro** | **US Dollar** | **Other** | **Total** |
| | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** |
| Sterling | - | 14,438 | (513) | 56 | 13,981 |
| Euro | - | - | - | - | - |
| Total | - | 14,438 | (513) | 56 | 13,981 |

The corresponding monetary assets and liabilities as at 31st December 2003 for comparison purposes were as follows:

| | Net foreign currency monetary assets/(liabilities) | | | | |
|---|---|---|---|---|---|
| **Functional currency of operation** | **Sterling** | **Euro** | **US Dollar** | **Other** | **Total** |
| | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** |
| Sterling | - | 6,792 | (944) | - | 5,848 |
| Euro | (9,363) | - | 3,812 | - | (5,551) |
| Total | (9,363) | 6,792 | 2,868 | - | 297 |

## NOTES TO THE FINANCIAL STATEMENTS (continued)
As at 31st December 2004

## 26. ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCY

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Assets** | | |
| Denominated in sterling | 4,654,784 | 3,556,482 |
| Denominated in currencies other than sterling | 33,376 | 102,423 |
| | 4,688,160 | 3,658,905 |
| ***Liabilities*** | | |
| Denominated in sterling | 4,668,765 | 3,639,142 |
| Denominated in currencies other than sterling | 19,395 | 19,763 |
| | 4,688,160 | 3,658,905 |

## 27. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

The Company does not trade in financial instruments. Other than those disclosed in Note 23, there were no material differences at 31st December 2004 or 31st December 2003 between the recorded values of all assets and liabilities of the Company and their estimated fair values.

## 28. SEGMENTAL ANALYSIS

No segmental analysis has been provided as the Company operates solely in Europe and has only one class of business, being the issue of credit cards and other ancillary banking services.

## 29. COMMITMENTS

| **Operating lease commitments** | **2004** | | **2003** | |
|---|---|---|---|---|
| | **Land and buildings** | **Other** | **Land and buildings** | **Other** |
| **Annual commitments under non-cancellable operating leases expiring:** | **£'000** | **£'000** | **£'000** | **£'000** |
| within 1 year | 96 | 2 | 944 | 361 |
| between 1 and 5 years | - | - | - | - |
| over 5 years | 6,307 | - | 6,307 | - |
| | 6,403 | 2 | 7,251 | 361 |

## NOTES TO THE FINANCIAL STATEMENTS (continued)

As at 31st December 2004

## 30. DIRECTORS' EMOLUMENTS AND TRANSACTIONS

The amount of emoluments paid to the Directors is:

| | 2004 £'000 | 2003 £'000 |
|---|---|---|
| **Aggregate emoluments** | 674 | 617 |
| **Aggregate pension contributions** | 77 | 72 |

The total remuneration of the highest paid Director was £555,000 (2003: £542,000). The amount of Company contributions paid to the pension scheme on behalf of the highest paid Director was £77,000 (2003: £72,000). One Director exercised share options in the Corporation in the year (2003: 2). One Director who served during the year was a member of the Capital One Group Personal Pension Scheme (2003: 1). The number and total amount outstanding of loans to Directors, connected persons and officers as at 31st December 2004 were 7 (2003: 20) and £13,396 (2003: £43,436) respectively.

## 31. RELATED PARTIES

Transactions with other companies within the Capital One Group are not disclosed due to the exemption allowed by FRS 8 'Related Party Disclosures' (Note 32).

## 32. ULTIMATE PARENT UNDERTAKING

The Company's immediate parent company is Capital One Holdings Limited, a company incorporated in the United Kingdom. The Company's ultimate parent company is Capital One Financial Corporation, which is incorporated in the United States of America. The consolidated financial statements of Capital One Holdings Limited and Capital One Financial Corporation, both of which include the Company, are available from the Company's registered office.