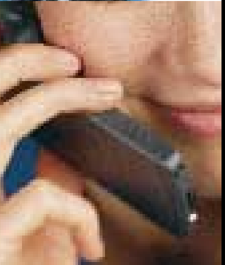


Capital One Financial Corporation

1998 Annual Report

The Innovation Imperative

Capital One Financial Corporation

Capital One Financial Corporation, based in Falls Church, Virginia, is one of the fastest-growing, most profitable companies in the United States. Using a proprietary Information-Based Strategy to generate constant innovation, Capital One has quickly become one of the world's largest issuers of credit cards and a direct marketer of consumer lending products. It is also a pioneer in the direct marketing of wireless phone service.

As of December 31, 1998, the company had $17.4 billion in managed loans and 16.7 million customers in the United States, Canada and the United Kingdom. Our 10,000 associates are based in Falls Church, Richmond and Fredericksburg, Virginia; Tampa, Florida; Dallas/Fort Worth, Texas; Federal Way, Washington; Boston, Massachusetts; and London and Nottingham, England.

The common stock of Capital One Financial Corporation, part of the Standard & Poor's 500 Index, trades on the New York Stock Exchange under the symbol COF.

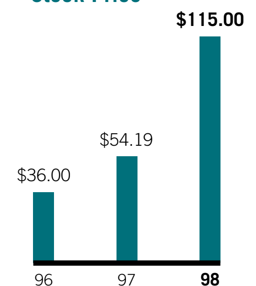
Capital One® is a registered trademark of Capital One Financial Corporation.

Financial Summary

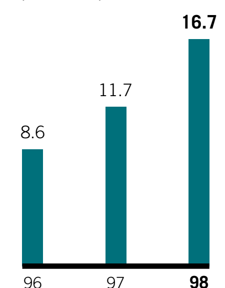
(Dollars in Thousands, Except Per Share Data)	1998	1997	Percent Change
	Year Ended December 31		
Earnings:			
Net interest income	**$ 694,782**	$ 383,138	81.34%
Non-interest income	**1,488,283**	1,069,130	39.21
Marketing	**446,264**	224,819	98.50
Other non-interest expense	**1,025,852**	659,159	55.63
Net income	**275,231**	189,381	45.33
Tax rate	**38.0%**	38.0%	
Per Common Share:			
Basic earnings	**$ 4.20**	$ 2.87	46.34
Diluted earnings	**3.96**	2.80	41.43
Dividends	**.32**	.32	
Book value as of year-end	**19.35**	13.66	41.65
Market prices			
Year-end	**115**	54 3/16	112.23
High	**129 15/16**	54 3/16	139.79
Low	**50 9/16**	31 3/8	61.16
Price/Earnings ratio	**29.04**	19.35	50.08
Ratios:			
Return on average assets	**3.30%**	2.88%	14.58
Return on average equity	**25.30**	22.98	10.10
Capital to assets	**14.53**	14.00	3.76
Allowance for loan losses to loans as of year-end	**3.75**	3.76	(0.22)
Managed Consumer Loan Data:			
Average reported loans	**$ 5,348,559**	$ 4,103,036	30.36
Average securitized loans	**9,860,978**	8,904,146	10.75
Average total managed loans	**15,209,537**	13,007,182	16.93
Year-end reported loans	**6,157,111**	4,861,687	26.65
Year-end securitized loans	**11,238,015**	9,369,328	19.94
Year-end total managed loans	**17,395,126**	14,231,015	22.23
Year-end total accounts (000s)	**16,706**	11,747	42.22
Yield	**16.99%**	15.73%	8.00
Net interest margin	**9.95**	8.86	12.32
Delinquency rate (30+ days)	**4.70**	6.20	(24.19)
Net charge-off rate	**5.33**	6.59	(19.12)
Year-End Reported Data:			
Assets	**$ 9,419,403**	$ 7,078,279	33.07
Earning assets	**8,238,091**	6,337,041	30.00
Average assets	**8,330,432**	6,568,937	26.82
Average earning assets	**7,225,835**	5,753,997	25.58
Common equity	**1,270,406**	893,259	42.22
Associates (FTE's)	**10,432**	5,906	76.63
Shares outstanding (000s)	**65,660**	65,369	0.44
Common stockholders of record	**9,692**	10,585	(8.44)

Diluted Earnings Per Share

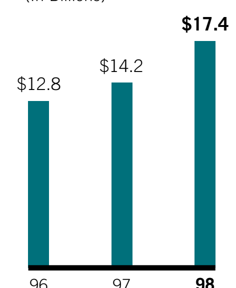
Year-End Stock Price



Total Accounts
(In Millions)



Managed Loans
(In Billions)



Richard D. Fairbank
Chairman and Chief Executive Officer

Nigel W. Morris
President and Chief Operating Officer

Fellow Stockholders:

In 1998, for the fourth straight year, Capital One broke records across the board and broke them by wide margins. We see this long winning streak as testimony to the power of our Information-Based Strategy, our success in executing it and the commitment we have made to innovation in every part of the company.

At the time of our initial public offering in November 1994, we announced two highly ambitious goals for Capital One: annual per share earnings growth and annual return on equity of at least 20%. We have surpassed both goals for four consecutive years and have already announced that we expect to surpass them again in 1999. Our consumer franchise now includes one of every seven U.S. households, and our loan portfolio has grown to $17.4 billion. We were delighted that a share of Capital One stock, worth $16 on the day we went public, traded for $115 on December 31, 1998.

The company's 1998 net income of $275.2 million, or $3.96 per share, was up more than 40% from $189.4 million, or $2.80 per share, in 1997. In addition, we doubled our marketing investment to $446 million, particularly noteworthy in a year of such strong earnings growth. This investment, which funds current marketing efforts and the vast testing we do to find and pursue new opportunities, generates a steady stream of innovation and growth for Capital One.

In 1998, for the fourth straight year, Capital One broke records across the board and broke them by wide margins.

Total revenue (managed net interest income plus non-interest income) also reached record levels, rising 33% to $2.8 billion in 1998 from $2.1 billion in 1997. Managed net interest income was up 31% to $1.7 billion, the result of an increase of 109 basis points in the net interest margin and a 22% increase in managed loans. Managed non-interest income was up 38% to $1.1 billion.

For the third consecutive year, Capital One's rate of account growth (42%) set a record. We added an impressive 14,000 net new accounts a day. In the last quarter, the pace accelerated to 20,000 a day. We ended the year with 16.7 million customers—almost 5 million more than we had at the end of 1997.

Credit performance was outstanding. Delinquencies declined throughout the year to 4.70% as of December 31, 1998, compared with 6.20% a year earlier. Charge-offs improved 186 basis points to 4.51% for the fourth quarter of 1998, compared with 6.37% in the fourth quarter 1997. Capital One's fourth quarter net charge-offs as a percentage of managed loans were among the industry's lowest.

While 1998's credit performance benefited from an improved consumer credit environment, it also reflects the success of Capital One's approach to credit and marketing. We couple highly sophisticated credit modeling with credit policies and pricing closely matched to the risk profile of each customer. And our marketing success with customers that we have dubbed "superprime" has significantly changed the mix of our loan portfolio: 30% of our loans now represent borrowings by these customers. These are high-income, very low-risk customers who are even more attractive than the "prime" customers that are the target of most of our industry's marketing efforts. Over the last two years, with innovative products designed for the highly diverse needs of superprime customers, we

have grown their loans by $5.0 billion. As expected, our superprime loans are performing very well.

Capital One's risk-adjusted margin widened to a record 12.21% for the fourth quarter of 1998 from 9.10% a year earlier. Risk-adjusted margin (total managed revenue less managed net charge-offs as a percentage of average managed earning assets) is a key measure of profitability in the credit card industry, and ours is one of the best.

The company has a strong balance sheet, with a high ratio of capital to managed assets and substantial liquidity. In good times our balance sheet liquidity creates great flexibility in raising the funds required to meet the borrowing needs of our growing customer base. In times of turmoil, such as last fall's global liquidity crisis, it enables Capital One to continue business without interruption.

Capital One's success continues to be powered by the very same strategy we developed more than a decade ago, our Information-Based Strategy. The strategy is to leverage technology, information and scientific testing to create a quantum improvement in marketing capability. Our goal: to leapfrog high-priced, one-size-fits-all marketing with "mass customization," delivering the right product to the right consumer at the right time and at the right price.

At the heart of the strategy is the use of scientific testing on a massive scale. We use testing to learn how to customize products and services to the individual consumer; we also use testing to build an innovation laboratory capable of creating a steady stream of new ideas to stay ahead of the competition. Testing also allows us to cost-effectively explore many possibilities, and to know in advance the likely results of the products and programs we are rolling out.

We have literally turned the business into a scientific laboratory. In 1998, we conducted 27,000 tests of products, prices, features, packages, marketing channels, credit policies, account management, customer service, collections and retention.

We have always recognized that rapid technological advances create an "innovation imperative." Product life cycles are getting shorter and shorter, pushing marketers to move faster and faster to stay ahead of the competition. Capital One is specifically designed for this environment. Our strategy, people, technology, operations and culture are built to deliver on the innovation imperative.

Our strategy, people, technology, operations and culture are built to deliver on the innovation imperative.

We chose credit cards as our initial focus because they are ideal for direct marketing and because they presented an opportunity to use our Information-Based Strategy to transform an industry. The strategy has been rewarding for Capital One and beneficial to consumers. The thousands of product variations we offer have created more choice, wider access to credit and lower borrowing costs for most consumers.

Although Capital One's revenues still come primarily from U.S. credit cards, we are successfully applying our strategy to other geographies and businesses. In the United Kingdom and Canada, our credit cards are winning market share through customization and lower prices. With America One, we are reinventing the marketing of wireless phone service by selling directly to consumers and mass customizing

our service to expand their choices. America One opens a major avenue of diversification for us and has the potential to produce a large and profitable annuity-like stream of income.

In July 1998, we also entered the auto lending business with the acquisition of Summit Acceptance Corporation of Dallas, Texas. Summit gives us a testing platform in a financial sector we believe is well suited to our Information-Based Strategy and ready for fundamental change.

The broad applicability of our strategy puts Capital One in an excellent position to capitalize on macrotrends that have been reshaping the world for the last decade and will continue to shape it in the next:

- Direct marketing, which opens up the opportunity to test and customize, to capture information and to roll out innovations quickly and inexpensively.
- The Internet, the ultimate direct marketing channel which brings our Information-Based Strategy into real time.
- Information technology, as continuing advances in the ability to collect, process, store and use information are accelerating the opportunities for technology-based marketing.
- Globalization, which gives rise to marketing opportunities all over the world.
- Excellent product growth trends. The credit card is steadily replacing cash and checks as the preferred medium of exchange. Wireless phones are becoming a mass consumer product as the cost of service becomes more affordable.

With the information-based company we've built, and the broad, rapid innovation it supports, we see an outstanding future for Capital One. We are aligned to ride the macrotrends. And we're moving toward our vision of a company that is not dependent on the fortunes of a single industry or geography.

Our confidence in the company's long-term success is so strong that the two of us continue to forgo current compensation in exchange for the possibility of greater rewards in the future. In June 1998, having already given up our salaries and bonuses, we traded vested stock options, valued at $8.8 million, for new options that will not vest unless Capital One's stock price reaches $175 by June 11, 2001. (This represents a compound annual increase of 20% for three years.) Our options are part of a compensation plan that, in 1998, allowed 273 senior managers to forgo up to half their annual cash bonuses for options. An overwhelming majority (82%) chose to participate.

More than 40% of our associates take part in the company's stock purchase plan, one of the highest participation levels in corporate America. Last spring, to foster the entrepreneurial spirit that goes hand in hand with ownership, we once again granted stock options to all associates (excluding senior executives). The option and compensation plans are described on pages 47–49.

Knowing the success of our strategy depends entirely on the caliber of our people, we have always seen recruiting as our most important business. We are deeply committed to finding and empowering world-class talent. To attract the best of the best, we've created a company that offers associates unusually broad opportunities to pursue their entrepreneurial dreams, develop their leadership

Knowing the success of our strategy depends entirely on the caliber of our people, we have always seen recruiting as our most important business.

potential and move up. As a result, Capital One has quickly earned a reputation as a place to build a great career. *Fortune* magazine now ranks us as one of the 100 Best Companies to Work for in America. Quite a change from just four years ago, when recruits were inclined to ask "Capital Who?" Our associates have always given the company high marks in satisfaction surveys conducted by an independent research firm, and in 1998, the scores hit all-time highs. In fact, our scores are among the highest of any U.S. company.

Capital One has earned a reputation as a place to build a great career. *Fortune* magazine now ranks us as one of the 100 Best Companies to Work For in America.

With unemployment at a 28-year low in 1998, competition for talent was stiff. But our retention rate was the best ever and we added 4,526 associates—an increase of 77%—without lowering our high standards by an inch. We're extremely proud of those accomplishments. We're also very gratified by the energy, creativity and excellence our associates showed in driving the year's rapid growth and innovation.

The top-flight performance of our associates continues to win awards for Capital One. In 1998, our excellence in financial management was recognized with not one but three Alexander Hamilton Awards from *Treasury & Risk Management* magazine. Innovation in cross-selling, and the technology behind it, earned an Enterprise Value Award from *CIO* magazine. And *Future Banker* magazine named us Future Bankers of the Year.

As a company, and through the individual efforts of our associates, we're making a long-term social investment that is already paying major dividends in the communities where we do business. Each year, we contribute our time, skills, technology and funds to organizations that are improving opportunities for children at risk. For example, in 1998, we reaffirmed our commitment to our innovative $1.5 million Leadership Grants program which enhances the effectiveness of five service agencies in Richmond, Virginia, by furthering collaboration among them. Our associates are helping them as volunteer tutors, mentors and computer consultants. We also joined a partnership to teach basic job skills to high school and community college students. And we started a scholarship program that rewards improvement in math and science grades.

As we begin 1999, Capital One is stronger than ever. We're building on four years of record earnings, record marketing investments and record levels of innovation. But in all our businesses, competition is fierce. We welcome the challenge. And we intend to meet it in the future as we have in the past: by constantly reinventing ourselves, our products and our company.

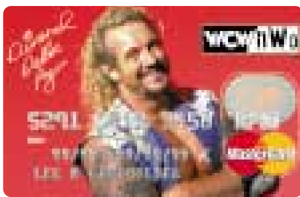
Richard D. Fairbank
Chairman and Chief Executive Officer

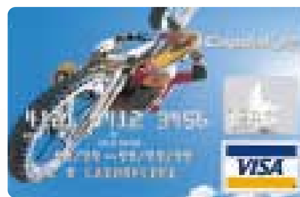
Nigel W. Morris
President and Chief Operating Officer

Change or die. That is the imperative of the Information Age.

Back at the dawn of the century, Henry Ford's Model T ruled the road for almost 20 years before competitors made it obsolete. Now we see our competition in the rearview mirror in a matter of months. So our commitment to innovation is total. It's built into our strategy and into every associate, every department, every piece of technology, every process and every test of new ideas. Our goal: be first to market, roll out at full speed, then move on. Rather than wait for the competition to obsolete our products, we do it ourselves. Capital One's strategy is working. The proof is in the profits and in the growth. Our innovation is constant. Half of what we now market did not exist six months ago. Here is a look under the hood of our innovation machine and a glimpse at the future our innovators are creating for Capital One.

Capital One

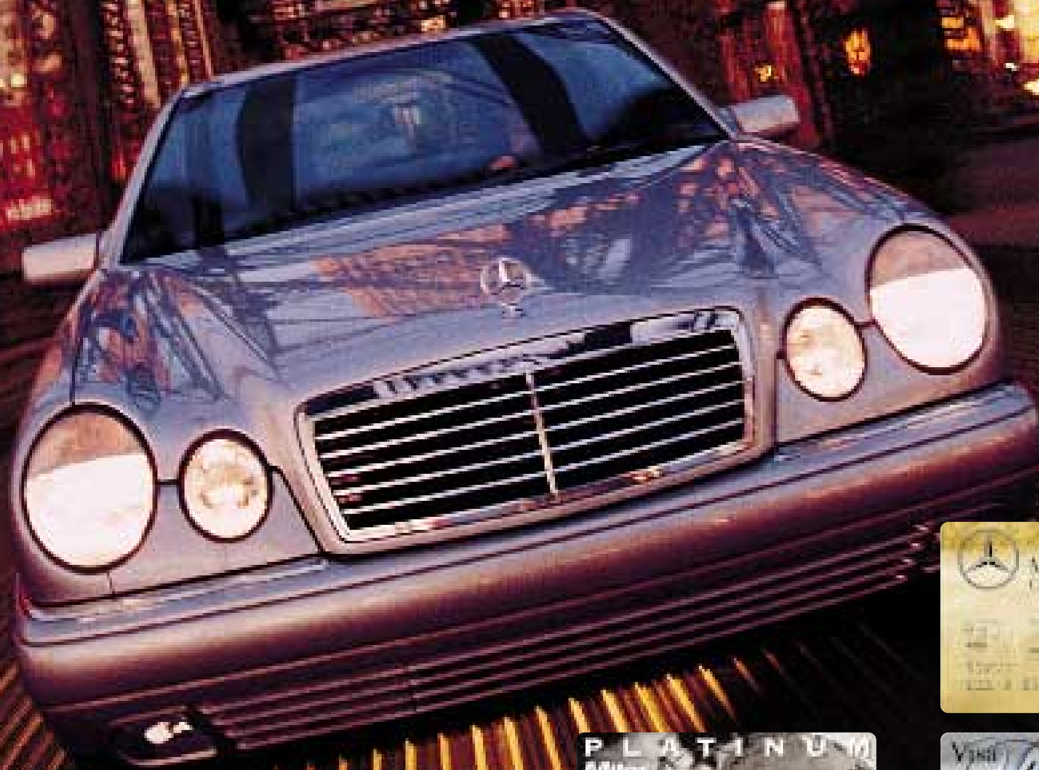




We market directly to the heart. By combining our Information-Based Strategy with one of the world's largest data warehouses, we're using mass customization to market to people's passions. Some of our competitors offer affinity cards by forming alliances with clubs and other groups to create cards for their members. We leapfrog the groups and go direct, with cards celebrating the passion of individuals who enjoy everything from biking and hiking to birdwatching and gardening. With our skill in micro-segmentation, we can find and target very small pockets of passion. Our cards for music lovers, for example, feature designs with classical, rock, country and jazz motifs. We also offer a long list of cards aimed at the pride people feel in their occupations and their ethnic heritage. We've found the smaller the segment, the greater the passion. The greater the passion, the stronger the response to our marketing. Our approach allows us to tailor credit limits and pricing to each customer—a critical advantage over relationships with affinity groups, most of which insist all members be treated alike. And by removing the third party from the relationship, we can pass on savings to consumers as well as generate higher returns for Capital One.

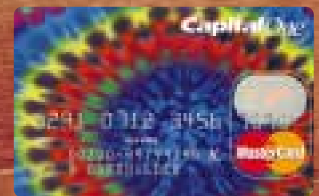
Mercedes-Benz
Credit Corporation

Everybody in our industry wants blue-chip customers. We've got them. And they're the fastest-growing segment of our business. Most card issuers treat all affluent customers with good credit histories alike. We know this market is not a monolith. It's a mosaic of many, many micro-segments. We're rapidly growing our business with these "superprime" customers by using scientific testing and mass customization to create distinctive products serving a multiplicity of needs. The 9.9% fixed rate card we introduced for the superprime market is widely recognized as a best buy. Our Miles One frequent flyer program comes without blackout periods or seat restrictions and is redeemable on any airline. Because of our commitment to looking after customers, Mercedes-Benz invited us to create a card offering Mercedes drivers the high prestige and quality of its own brand. The card has been a big success. As we have pushed innovation and microsegmentation to new levels in this market, superprime loans have grown to 30% of our portfolio in only two years. In the process, we have given Capital One a gateway to America's premier consumer market. Through further innovation and segmentation, we expect continued growth with superprime customers.



Our Information-Based Strategy travels well. In the United Kingdom and Canada, we're winning customers with innovative products that are slashing the price of credit cards—a major consumer benefit in markets long dominated by banks charging 20% or more. Through scientific testing and mass customization, we can create products for multiple geographies and tailor the terms of our accounts to the customer's financial profile. We were the first major U.S. credit card issuer to enter the Canadian market with a Platinum credit card. Capital One has given Britons their first opportunity to personalize the look of their credit cards with a photograph. Our Capital Card offers discounts at many stores and restaurants in greater London. We now have 500 associates serving our U.K. customers from an operations center in Nottingham. By the end of 1999, the center will employ 900. Nottingham is also our springboard to the Continent, where the market is large and relatively untapped. Our long-term vision: a profitable global franchise for Capital One.

Today's college students are tomorrow's superprime customers. The college market gives us an opportunity to begin relationships we hope will last a lifetime. We want the first credit card in a student's wallet to be one of ours. Our credit cards are designed to help students stretch their dollars. We offer low prices, airline discounts and other bargains geared to student needs. These customers are often new to the world of credit, so we feel it's important to help them off to a responsible start—that's why we keep our student credit lines low. After college, as their incomes grow, we want to grow with them. By treating our college customers well, we're building toward the day when Capital One will be their preferred source for a wide range of innovative, high-value products.



In wireless, we've done more than cut the cord. We're reinventing the marketing of wireless phone service with the same successful strategy we use for credit cards. In the card business, we buy funds wholesale and lend them retail, and we market directly rather than through retail middlemen. In America One, our wireless business, we buy air time wholesale from phone companies and resell it to our retail customers. Instead of selling in stores like other wireless companies, we solicit customers directly, creating a powerful set of advantages for Capital One. Without the middleman, we can offer some of the best deals on the market, as well as the convenience of shopping at home. We customize our solicitations, providing consumers with free minutes, a variety of pricing and service options, and a choice of phones from Motorola, Nokia, Ericsson and others. We can acquire the customers without having to build expensive networks. As technology evolves, we can evolve with it, always marketing the latest and best. Freed from towers, bricks and mortar, we can roll out nationwide quickly and economically. America One gives us a beachhead in a large, fast-growing industry that meshes perfectly with our Information-Based Strategy.

We’d like to shift the gears of auto finance. Capital One’s first acquisition, completed last summer, takes the company into another large sector of consumer finance. Summit Acceptance Corporation, based in Dallas, Texas, provides auto loans to borrowers across the country. We see Summit as a platform for testing our Information-Based Strategy, which we believe has the potential to transform an industry still largely reliant on traditional marketing and lending practices. We are beginning by integrating our technologies and scientifically testing new marketing ideas. Summit’s management has built a solid company with a successful track record and is well suited to partner with Capital One.

With the Internet, we're wired to the world. Cyberspace is the marketplace of our dreams and the ultimate channel for our Information-Based Strategy. Interactions with Internet customers are data-rich and high-speed, allowing us to test and mass customize in real time. We expect to be able to maximize these advantages because our highly flexible organization is designed for rapid testing and rapid innovation. We now market Capital One products on popular search engines such as Yahoo!®, AltaVista™ and the DoubleClick Network™. Consumers can apply for our credit cards online, and we're building the infrastructure to enable customers to make payments and manage their accounts online. These are new conveniences for them and major gains for us since the Internet brings us new customers at low cost and has the potential to cut our account-servicing expenses. The Internet is the direct marketing channel of the future, and Capital One is committed to being a major player. **Come visit us at www.capitalone.com**

We're leveraging the power of our consumer franchise. The Capital One franchise now includes 16.7 million customers in three countries and is growing at the rate of 20,000 customers a day. Our ability to market value-added products to our customers is a big strategic advantage. We've made substantial investments in the people, technology, and compensation structures required to excel in customer service and sales. We have turned what is traditionally considered a "cost center" into a profit center as we market carefully selected, high quality branded products. For example, through Capital One's relationship with a leading insurance company, we can offer our customers the opportunity to save an average of $200 a year on auto insurance. More than half the customers we added in 1998 also purchased at least one other product from us. This cross selling builds customer loyalty and produces higher returns for Capital One. We are now well on the way toward our goal of becoming one of the largest consumer franchises in America.

1998 Financial Presentation

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Selected Financial and Operating Data

(Dollars In Thousands, Except Per Share Data)	1998	1997	1996	1995	1994(1)	Five-Year Compound Growth Rate
	Year Ended December 31					
Income Statement Data:						
Interest income	**$ 1,111,536**	$ 717,985	$ 660,483	$ 457,409	$ 258,672	33.73%
Interest expense	**416,754**	334,847	294,999	249,396	93,695	43.71
Net interest income	**694,782**	383,138	365,484	208,013	164,977	29.35
Provision for loan losses	**267,028**	262,837	167,246	65,895	30,727	50.99
Net interest income after provision for loan losses	**427,754**	120,301	198,238	142,118	134,250	22.07
Non-interest income	**1,488,283**	1,069,130	763,424	553,043	396,902	50.18
Non-interest expense	**1,472,116**	883,978	713,182	497,430	384,325	51.94
Income before income taxes	**443,921**	305,453	248,480	197,731	146,827	21.04
Income taxes	**168,690**	116,072	93,213	71,220	51,564	22.82
Net income	**$ 275,231**	$ 189,381	$ 155,267	$ 126,511	$ 95,263	20.03%
Dividend payout ratio	**7.46%**	10.90%	13.24%	12.55%		
Per Common Share:						
Basic earnings(2)	**$ 4.20**	$ 2.87	$ 2.34	$ 1.93	$ 1.44	20.26%
Diluted earnings(2)	**3.96**	2.80	2.32	1.91	1.44	18.85
Dividends	**.32**	.32	.32	.24		
Book value as of year-end	**19.35**	13.66	11.16	9.05	7.18	
Average common shares	**65,589,643**	66,069,897	66,227,631	65,690,838	66,067,250	
Average common and common equivalent shares	**69,588,432**	67,650,864	67,025,233	66,392,284	66,067,250	
Selected Average Balances:						
Securities	**$ 1,877,276**	$ 1,650,961	$ 1,147,079	$ 962,624	$ 62,626	
Allowance for loan losses	**(214,333)**	(132,728)	(83,573)	(69,939)	(66,434)	29.11%
Total assets	**8,330,432**	6,568,937	5,568,960	4,436,055	2,629,920	29.48
Deposits	**1,430,042**	958,885	1,046,122	769,688	36,248	
Other borrowings	**5,163,795**	4,350,864	3,623,104	2,952,162	2,287,474	19.17
Preferred beneficial interests	**97,793**	89,529				
Stockholders'/Division equity(3)	**1,087,983**	824,077	676,759	543,364	239,616	57.07
Selected Year-End Balances:						
Securities	**$ 2,080,980**	$ 1,475,354	$ 1,358,103	$ 1,244,195	$ 425,570	
Consumer loans	**6,157,111**	4,861,687	4,343,902	2,921,679	2,228,455	
Allowance for loan losses	**(231,000)**	(183,000)	(118,500)	(72,000)	(68,516)	
Total assets	**9,419,403**	7,078,279	6,467,445	4,759,321	3,091,980	
Deposits	**1,999,979**	1,313,654	943,022	696,037	452,201	
Borrowings	**5,383,672**	4,428,886	4,525,216	3,301,672	2,062,688	
Preferred beneficial interests	**97,921**	97,664				
Stockholders'/Division equity(3)	**1,270,406**	893,259	740,391	599,191	474,557	
Managed Consumer Loan Data:						
Average reported loans	**$ 5,348,559**	$ 4,103,036	$ 3,651,908	$ 2,940,208	$ 2,286,684	19.30%
Average off-balance sheet loans	**9,860,978**	8,904,146	7,616,553	6,149,070	3,910,739	56.45
Average total managed loans	**15,209,537**	13,007,182	11,268,461	9,089,278	6,197,423	36.03
Interest income	**2,583,872**	2,045,967	1,662,990	1,192,100	733,659	42.97
Year-end total managed loans	**17,395,126**	14,231,015	12,803,969	10,445,480	7,378,455	29.20
Year-end total accounts (000's)	**16,706**	11,747	8,586	6,149	5,049	39.89
Yield	**16.99%**	15.73%	14.76%	13.12%	11.84%	
Net interest margin	**9.95**	8.86	8.16	6.27	6.90	
Delinquency rate	**4.70**	6.20	6.24	4.20	2.95	
Net charge-off rate	**5.33**	6.59	4.24	2.25	1.48	
Operating Ratios:						
Return on average assets	**3.30%**	2.88%	2.79%	2.85%	3.62%	
Return on average equity	**25.30**	22.98	22.94	23.28	39.76	
Equity to assets (average)	**13.06**	12.55	12.15	12.25	9.11	
Allowance for loan losses to loans as of year-end	**3.75**	3.76	2.73	2.86	3.07	

(1) The Company's results prior to November 22, 1994, reflect operations as a division of Signet Bank. Prior to November 22, 1994, Signet Banking Corporation, the parent of Signet Bank, had provided significant financial and operational support to the Company.
(2) Assumes 66,067,250 shares outstanding prior to November 22, 1994.
(3) Division equity reflects an allocation of capital to Capital One Bank as a division for purposes of preparation of the financial statements of the Company. Such allocation is not subject to regulatory minimums.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Introduction

Capital One Financial Corporation (the "Corporation") is a holding company whose subsidiaries provide a variety of products and services to consumers using its Information-Based Strategy ("IBS"). The principal subsidiaries are Capital One Bank (the "Bank"), which offers credit card products, and Capital One, F.S.B. (the "Savings Bank"), which offers consumer lending products (including credit cards) and deposit products. The Corporation and its subsidiaries are collectively referred to as the "Company." As of December 31, 1998, the Company had 16.7 million customers and $17.4 billion in managed consumer loans outstanding and was one of the largest providers of MasterCard and Visa credit cards in the world.

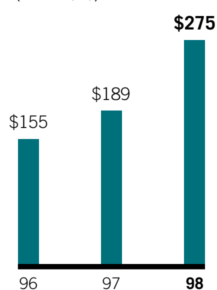
The Company's profitability is affected by the net interest income and non-interest income earned on earning assets, consumer usage patterns, credit quality, the level of marketing expense and operating efficiency. The Company's revenues consist primarily of interest income on consumer loans and securities, and non-interest income consisting of gains on securitizations of loans, servicing income and fees (such as annual membership, cash advance, cross-sell, interchange, overlimit, past-due and other fee income, collectively "fees"). The Company's primary expenses are the costs of funding assets, credit losses, operating expenses (including salaries and associate benefits), marketing expenses, processing expenses and income taxes.

Significant marketing expenses (e.g., advertising, printing, credit bureau costs and postage) to implement the Company's new product strategies are incurred and expensed prior to the acquisition of new accounts while the resulting revenues are recognized over the life of the acquired accounts. Revenues recognized are a function of the response rate of the initial marketing program, usage and attrition patterns, credit quality of accounts, product pricing and effectiveness of account management programs.

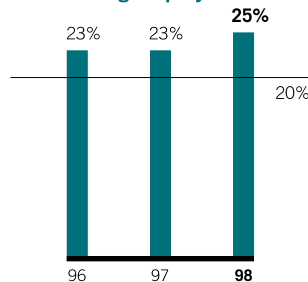
Earnings Summary

The following discussion provides a summary of 1998 results compared to 1997 results and 1997 results compared to 1996 results. Each component is discussed in further detail in subsequent sections of this analysis.

Net Income
(In Millions)



Return on Average Equity



Year Ended December 31, 1998 Compared to Year Ended December 31, 1997

Net income of $275.2 million, or $3.96 per share, for the year ended December 31, 1998, compares to net income of $189.4 million, or $2.80 per share, in 1997. The 45% increase in net income of $85.9 million, or $1.16 per share, is primarily the result of an increase in both asset and account volumes and an increase in net interest margin. Net interest income increased $311.6 million, or 81%, as average earning assets increased 26% and the net interest margin increased to 9.62% from 6.66%. The provision for loan losses increased $4.2 million, or 2%, as the reported net charge-off rate decreased to 4.24% in 1998 from 4.83% in 1997, offset by average reported consumer loans increasing 30%. Non-interest income increased $419.2 million, or 39%, primarily due to the increase in average managed accounts of 39%. Increases in marketing expenses of $221.4 million, or 98%, and salaries and benefits expense of $187.1 million, or 65%, reflect the increase in marketing investment in existing and new product opportunities and the cost of operations to manage the growth in the Company's accounts and products offered. Average managed consumer loans grew 17% for the year ended December 31, 1998, to $15.2 billion from $13.0 billion for the year ended December 31, 1997, and average accounts grew 39% for the same period to 13.8 million from 9.9 million as a result of the continued success of the Company's marketing and account management strategies.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Net income of $189.4 million, or $2.80 per share, for the year ended December 31, 1997, compares to net income of $155.3 million, or $2.32 per share, in 1996. The 22% increase in net income of $34.1 million, or $.48 per share, is primarily the result of an increase in both asset and account volumes, offset by a decrease in net interest margin. Net interest income increased $17.7 million, or 5%, as average earning assets increased 20%, offset by a decrease in the net interest margin to 6.66% from 7.62%. The provision for loan losses increased $95.6 million, or 57%, as average reported loans increased 12% and the reported charge-off rate increased to 4.83% in 1997 from 3.63% in 1996, as a result of an increase in the average age of accounts (generally referred to as "seasoning") and general economic trends in consumer credit performance. Non-interest income increased $305.7 million, or 40%, primarily as a result of the increase in average accounts of 33%, a shift to more fee-based accounts, a change in the timing and amount ("terms") of certain fees charged and the incremental impact of securitization accounting. Increases in salaries and benefits expense of $74.2 million, or 34%, and other non-interest expenses of $96.6 million, or 19%, primarily reflected the incremental cost of operations to manage the growth in the Company's accounts. Average managed consumer loans grew 15% for the year ended December 31, 1997, to $13.0 billion from $11.3 billion for the year ended December 31, 1996, and average accounts grew 33% for the same period to 9.9 million from 7.5 million as a result of the continued success of the Company's marketing and account management strategies.

Managed Consumer Loan Portfolio

The Company analyzes its financial performance on a managed consumer loan portfolio basis. Managed consumer loan data adds back the effect of off-balance sheet consumer loans. The Company also evaluates its interest rate exposure on a managed portfolio basis.

The Company's managed consumer loan portfolio is comprised of reported and off-balance sheet loans. Off-balance sheet loans are those which have been securitized in accordance with Statement of Financial Accounting Standards ("SFAS") No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS 125"), and are not assets of the Company. Therefore, those loans are not shown on the balance sheet.

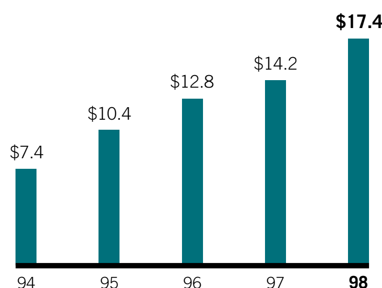
Table 1 summarizes the Company's managed consumer loan portfolio.

Table 1: Managed Consumer Loan Portfolio

	Year Ended December 31				
(In Thousands)	**1998**	1997	1996	1995	1994
Year-End Balances:					
Reported consumer loans	**$ 6,157,111**	$ 4,861,687	$ 4,343,902	$ 2,921,679	$2,228,455
Off-balance sheet consumer loans	**11,238,015**	9,369,328	8,460,067	7,523,801	5,150,000
Total managed consumer loan portfolio	**$17,395,126**	$14,231,015	$12,803,969	$10,445,480	$7,378,455
Average Balances:					
Reported consumer loans	**$ 5,348,559**	$ 4,103,036	$ 3,651,908	$ 2,940,208	$2,286,684
Off-balance sheet consumer loans	**9,860,978**	8,904,146	7,616,553	6,149,070	3,910,739
Total managed consumer loan portfolio	**$15,209,537**	$13,007,182	$11,268,461	$ 9,089,278	$6,197,423

As of December 31, 1998, the managed consumer loan portfolio consisted of 68% fixed and 32% variable interest rate loans. The Company's reported consumer loan portfolio as of December 31, 1998, consisted of 62% fixed and 38% variable interest rate loans.

Since 1990, the Company has actively engaged in consumer loan securitization transactions. Securitization involves the transfer by the Company of a pool of loan receivables to an entity created for securitizations, generally a trust or other special purpose entity ("the trusts"). The credit quality of the receivables is supported by credit enhancements, which may be in various forms including a letter of credit, a cash collateral guaranty or account, or a subordinated interest in the receivables in the pool. Certificates ($11.2 billion outstanding as of December 31, 1998) representing undivided ownership interests in the receivables are sold to the public through an underwritten offering or to private investors in private placement transactions. The Company receives the proceeds of the sale. The Company retains an interest in the trusts ("seller's interest") equal to the amount of the receivables transferred to the trust in excess of the principal balance of the certificates. The Company's interest in the trusts varies as the amount of the excess receivables in the trusts fluctuates as the accountholders make principal payments and incur new charges on the selected accounts. The securitization generally results in the removal of the receivables, other than the seller's interest, from the Company's balance sheet for financial and regulatory accounting purposes.



The Company's relationship with its customers is not affected by the securitization. The Company acts as a servicing agent and receives a fee for doing so.

Collections received from securitized receivables are used to pay interest to certificateholders, servicing and other fees, and are available to absorb the investors' share of credit losses. Amounts collected in excess of that needed to pay the above amounts are remitted to the Company, as described in Servicing and Securitizations Income.

Certificateholders in the Company's securitization program are generally entitled to receive principal payments either through monthly payments during an amortization period or in one lump sum after an accumulation period. Amortization may begin sooner in certain circumstances, including if the annualized portfolio yield

(consisting, generally, of interest and fees) for a three-month period drops below the sum of the certificate rate payable to investors, loan servicing fees and net credit losses during the period.

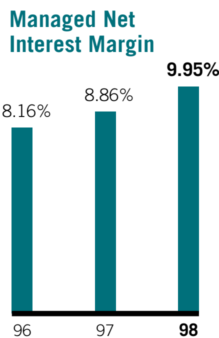
Prior to the commencement of the amortization or accumulation period, all principal payments received on the trusts' receivables are reinvested in new receivables to maintain the principle balance of certificates. During the amortization period, the investors' share of principal payments is paid to the certificateholders until they are paid in full. During the accumulation period, the investors' share of principal payments is paid into a principal funding account designed to accumulate amounts so that the certificates can be paid in full on the expected final payment date.

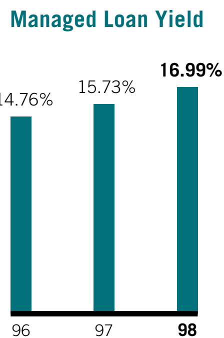
Table 2 indicates the impact of the consumer loan securitizations on average earning assets, net interest margin and loan yield for the periods presented. The Company intends to continue to securitize consumer loans.

Table 2: Operating Data and Ratios

	Year Ended December 31		
(Dollars in Thousands)	**1998**	1997	1996
Reported:			
Average earning assets	**$ 7,225,835**	$ 5,753,997	$ 4,798,987
Net interest margin(1)	**9.62%**	6.66%	7.62%
Loan yield	**18.75**	15.11	16.21
Managed:			
Average earning assets	**$17,086,813**	$14,658,143	$12,415,540
Net interest margin(1)	**9.95%**	8.86%	8.16%
Loan yield	**16.99**	15.73	14.76

(1) The net interest margin is equal to net interest income divided by average earning assets.





Risk Adjusted Revenue and Margin

The Company's products are designed with the objective of maximizing revenue for the level of risk undertaken. Management believes that comparable measures for external analysis are the risk adjusted revenue and risk adjusted margin of the managed portfolio. Risk adjusted revenue is defined as net interest income and non-interest income less net charge-offs. Risk adjusted margin measures risk adjusted revenue as a percentage of average earning assets. It considers not only the loan yield and net interest margin, but also the fee income associated with these products. By deducting net charge-offs, consideration is given to the risk inherent in these differing products.

The Company markets its card products to specific consumer segments. The terms of each card product are actively managed in an effort to maximize return at the consumer level, reflecting the risk and expected performance of the account. For example, card product terms typically include the ability to reprice individual accounts upwards or downwards based on the consumer's performance. In addition, during 1998, the Company aggressively marketed low non-introductory rate cards to consumers with the best established credit profiles to take advantage of the favorable risk return characteristics of this consumer segment. Industry competi-

tors have continuously solicited the Company's customers with similar interest rate strategies. Management believes the competition has put, and will continue to put, additional pressure on the Company's pricing strategies.

By applying its IBS and in response to dynamic competitive pressures, the Company also targets a significant amount of its marketing expense to other credit card product opportunities. Examples of such products include secured cards and other customized card products including affinity and co-branded cards, student cards and other cards targeted to certain markets that are underserved by the Company's competitors. These products do not have the immediate impact on managed loan balances of the balance transfer products but typically consist of lower credit limit accounts and balances that build over time. The terms of these customized card products tend to include annual membership fees and higher annual finance charge rates. The profile of the consumers targeted for these products, in some cases, may also tend to result in higher account delinquency rates and consequently higher past-due and overlimit fees as a percentage of loan receivables outstanding than the balance transfer products.

During 1997, the Company modified its methodology for charging off credit card loans (net of any collateral) to 180 days past-due, from the prior practice of charging off loans during the next billing cycle after becoming 180 days past-due. As a result, 1997 managed net interest income was reduced by $15.1 million and managed non-interest income was reduced by $8.0 million for the reversal of previously accrued finance charges and fee income. In addition, this modification increased managed net charge-offs by $47.4 million in 1997. Also, during 1997, the Company began recognizing the estimated uncollectible portion of finance charge and fee income receivables, which decreased loans by $50.2 million, managed net interest income by $19.8 million and managed non-interest income by $30.4 million. Risk adjusted revenue and risk adjusted margin, without these modifications, would have been $1.3 billion and 8.92%, respectively, in 1997.

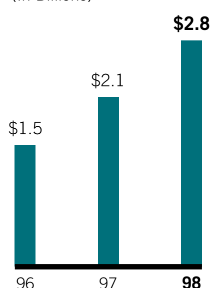
Table 3 provides income statement data and ratios for the Company's managed consumer loan portfolio. The causes of increases and decreases in the various components of risk adjusted revenue are discussed in further detail in subsequent sections of this analysis.

Table 3: Managed Risk Adjusted Revenue

	Year Ended December 31		
(Dollars in Thousands)	**1998**	1997	1996
Managed Income Statement:			
Net interest income	**$1,700,424**	$1,299,317	$1,013,557
Non-interest income[1]	**1,066,413**	743,516	460,492
Net charge-offs	**(810,306)**	(856,704)	(477,732)
Risk adjusted revenue	**$1,956,531**	$1,186,129	$ 996,317
Ratios[2]:			
Net interest margin	**9.95%**	8.86%	8.16%
Non-interest income	**6.24**	5.07	3.71
Net charge-offs	**(4.74)**	(5.84)	(3.85)
Risk adjusted margin	**11.45%**	8.09%	8.02%

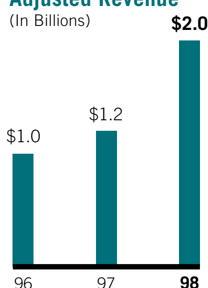
(1) For 1997, excludes $32 million pre-tax incremental impact on credit card securitizations income resulting from the implementation of SFAS 125.
(2) As a percentage of average managed earning assets.

Managed Revenue[1]
(In Billions)



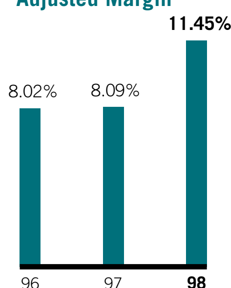
(1) Net interest and non-interest income.

Managed Risk Adjusted Revenue[2]
(In Billions)



(2) Net interest income plus non-interest income less net charge-offs.

Managed Risk Adjusted Margin



Net Interest Income

Net interest income is interest and past-due fees earned from the Company's consumer loans and securities less interest expense on borrowings, which include interest-bearing deposits, other borrowings and borrowings from senior and deposit notes.

Reported net interest income for the year ended December 31, 1998, was $694.8 million compared to $383.1 million for 1997, representing an increase of $311.6 million, or 81%. Net interest income increased as a result of growth in earning assets and an increase in the net interest margin. Average earning assets increased 26% for the year ended December 31, 1998, to $7.2 billion from $5.8 billion for the year ended December 31, 1997. The reported net interest margin increased to 9.62% in 1998, from 6.66% in 1997 primarily attributable to a 364 basis point increase in the yield on consumer loans to 18.75% for the year ended December 31, 1998, from 15.11% for the year ended December 31, 1997. The yield on consumer loans increased primarily due to an increase in the amount and frequency of past-due fees as compared to the prior year. In addition, the Company's continued shift to higher yielding products, offset by growth in low non-introductory rate products, contributed to the increase in yield on consumer loans during the same periods.

The managed net interest margin for the year ended December 31, 1998, increased to 9.95% from 8.86% for the year ended December 31, 1997. This increase was primarily the result of a 126 basis point increase in consumer loan yield for the year ended December 31, 1998, offset by an increase of nine basis points in borrowing costs for the same period, as compared to 1997. The increase in consumer loan yield to 16.99% for the year ended December 31, 1998, from 15.73% in 1997 principally reflected increases in the amount and frequency of changes in past-due fees and growth in higher yielding loans. The average rate paid on borrowed funds increased slightly to 6.04% for the year ended December 31, 1998, from 5.95% in 1997, reflecting the Company's shift to more fixed rate funding to match the increase in fixed rate consumer loan products.

Reported net interest income for the year ended December 31, 1997 was $383.1 million, compared to $365.5 million for 1996, representing an increase of $17.6 million, or 5%. Average earning assets increased 20% to $5.8 billion for the year ended December 31, 1997, from $4.8 billion in 1996. The reported net interest margin decreased to 6.66% in 1997, from 7.62% in 1996 and was primarily attributable to a 110 basis point decrease in the yield on consumer loans to 15.11% for the year ended December 31, 1997, from 16.21% for 1996. The yield on consumer loans decreased due to the removal from the balance sheet through securitization of higher yielding credit card products during the fourth quarter of 1996 and a $24.4 million reduction in reported consumer loan income as a result of modifications in the charge-off policy and finance charge and fee income recognition previously discussed. These decreases were offset by an increase in the amount of past-due fees charged from both a change in terms and an increase in the delinquency rate as compared to 1996.

The managed net interest margin for the year ended December 31, 1997, increased to 8.86% from 8.16% for the year ended December 31, 1996. This increase was primarily the result of a 97 basis point increase in consumer loan yield for the year ended December 31, 1997, offset by an 11 basis point increase in borrowing costs for the same period, as compared to 1996. The increase in consumer loan yield to 15.73% for the year ended December 31, 1997, from 14.76% in 1996 principally reflected the 1997 repricing of introductory rate loans, changes in product mix and the increase in past-due fees charged on delinquent accounts noted above. The average rate paid on borrowed funds increased slightly to 5.95% for the year ended December 31, 1997, from 5.84% in 1996, primarily reflecting a relatively steady short-term interest rate environment during 1997 and 1996.

Table 4 provides average balance sheet data, an analysis of net interest income, net interest spread (the difference between the yield on earning assets and the cost of interest-bearing liabilities) and net interest margin for each of the years ended December 31, 1998, 1997 and 1996.

Table 4: Statements of Average Balances, Income and Expense, Yields and Rates

	Year Ended December 31								
	1998			1997			1996		
(Dollars in Thousands)	**Average Balance**	**Income/ Expense**	**Yield/ Rate**	Average Balance	Income/ Expense	Yield/ Rate	Average Balance	Income/ Expense	Yield/ Rate
Assets:									
Earning assets									
Consumer loans[1]	**$5,348,559**	**$1,003,122**	**18.75%**	$4,103,036	$619,785	15.11%	$3,651,908	$592,088	16.21%
Federal funds sold and resale agreements	**231,312**	**12,564**	**5.43**	293,119	16,423	5.60	394,939	21,293	5.39
Other	**1,645,964**	**95,850**	**5.82**	1,357,842	81,777	6.02	752,140	47,102	6.26
Total earning assets	**7,225,835**	**$1,111,536**	**15.38%**	5,753,997	$717,985	12.48%	4,798,987	$660,483	13.76%
Cash and due from banks	**4,385**			(2,636)			40,698		
Allowance for loan losses	**(214,333)**			(132,728)			(83,573)		
Premises and equipment, net	**201,173**			181,610			156,441		
Other	**1,113,372**			768,694			656,407		
Total assets	**$8,330,432**			$6,568,937			$5,568,960		
Liabilities and Stockholders' Equity:									
Interest-bearing liabilities									
Deposits	**$1,430,042**	**$ 67,479**	**4.72%**	$ 958,885	$ 41,932	4.37%	$1,046,122	$ 56,272	5.38%
Other borrowings	**1,376,156**	**88,600**	**6.44**	631,876	39,066	6.18	454,899	28,509	6.27
Senior and deposit notes	**3,787,639**	**260,675**	**6.88**	3,718,988	253,849	6.83	3,168,205	210,218	6.64
Total interest-bearing liabilities	**6,593,837**	**$ 416,754**	**6.32%**	5,309,749	$334,847	6.31%	4,669,226	$294,999	6.32%
Other	**550,819**			345,582			222,975		
Total liabilities	**7,144,656**			5,655,331			4,892,201		
Preferred beneficial interests	**97,793**			89,529					
Stockholders' equity	**1,087,983**			824,077			676,759		
Total liabilities and stockholders' equity	**$8,330,432**			$6,568,937			$5,568,960		
Net interest spread			**9.06%**			6.17%			7.44%
Interest income to average earning assets			**15.38**			12.48			13.76
Interest expense to average earning assets			**5.76**			5.82			6.14
Net interest margin			**9.62%**			6.66%			7.62%

(1) Interest income includes past-due fees on loans of approximately $301,979, $132,297 and $94,393 for the years ended December 31, 1998, 1997 and 1996, respectively.

Interest Variance Analysis

Net interest income is affected by changes in the average interest rate earned on earning assets and the average interest rate paid on interest-bearing liabilities. In addition, net interest income is affected by changes in the volume of earning assets and interest-bearing liabilities. Table 5 sets forth the dollar amount of the increases (decreases) in interest income and interest expense resulting from changes in the volume of earning assets and interest-bearing liabilities and from changes in yields and rates.

Table 5: Interest Variance Analysis

	Year Ended December 31					
	1998 vs. 1997			1997 vs. 1996		
	Increase	Change Due to[1]		Increase	Change Due to[1]	
(In Thousands)	(Decrease)	Volume	Yield/Rate	(Decrease)	Volume	Yield/Rate
Interest Income:						
Consumer loans	**$383,337**	**$213,453**	**$169,884**	$ 27,697	$ 69,924	$(42,227)
Federal funds sold and resale agreements	**(3,859)**	**(3,371)**	**(488)**	(4,870)	(5,676)	806
Other	**14,073**	**16,856**	**(2,783)**	34,675	36,545	(1,870)
Total interest income	**393,551**	**206,040**	**187,511**	57,502	123,085	(65,583)
Interest Expense:						
Deposits	**25,547**	**22,007**	**3,540**	(14,340)	(4,422)	(9,918)
Other borrowings	**49,534**	**47,854**	**1,680**	10,557	10,947	(390)
Senior and deposit notes	**6,826**	**4,713**	**2,113**	43,631	37,446	6,185
Total interest expense	**81,907**	**81,157**	**750**	39,848	40,394	(546)
Net interest income[1]	**$311,644**	**$113,910**	**$197,734**	$ 17,654	$ 67,129	$(49,475)

(1) The change in interest due to both volume and yield/rates has been allocated in proportion to the relationship of the absolute dollar amounts of the change in each. The changes in income and expense are calculated independently for each line in the table. The totals for the volume and yield/rate columns are not the sum of the individual lines.

Servicing and Securitizations Income

In accordance with SFAS 125, the Company records gains or losses on the securitizations of consumer loan receivables on the date of sale based on the estimated fair value of assets sold and retained and liabilities incurred in the sale. Gains represent the present value of estimated excess cash flows the Company has retained over the estimated outstanding period of the receivables and are included in servicing and securitizations income. This excess cash flow essentially represents an "interest only" ("I/O") strip, consisting of the excess of finance charges and past-due fees over the sum of the return paid to certificateholders, estimated contractual servicing fees and credit losses. However, exposure to credit losses on the securitized loans is contractually limited to these cash flows.

Servicing and securitizations income increased $107.5 million, or 16%, to $789.8 million for the year ended December 31, 1998, from $682.3 million in 1997. This increase was primarily due to an increase of 11% in average off-balance sheet loans. Also contributing to this increase were decreased charge-offs on such loans as a result of improving consumer credit.

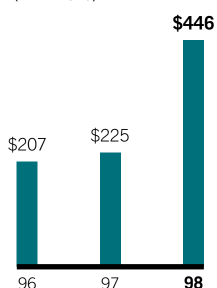
The increase in servicing and securitizations income of $222.5 million, or 48%, to $682.3 million for the year ended December 31, 1997, from $459.8 million for 1996 was due to a number of factors, including the incremental effect of the implementation of SFAS 125 and a 17% increase in average off-balance sheet loans. The incremental effect of adopting the requirements of SFAS 125 was to increase servicing and securitizations income in 1997 by $32.0 million ($19.8 million net of tax). Prior to 1997, no gains were recorded due to the relatively short average life of the consumer loans securitized. Excess servicing fee income was recorded over the life of each sale transaction.

Certain estimates inherent in the determination of the fair value of the I/O strip are influenced by factors outside the Company's control, and as a result, such estimates could materially change in the near term. Any future gains that will be recognized in accordance with SFAS 125 will be dependent on the timing and amount of future securitizations. The Company will continuously assess the performance of new and existing securitization transactions as estimates of future cash flows change.

Other Non-Interest Income

Interchange income increased $37.5 million, or 76%, to $86.5 million for the year ended December 31, 1998, from $49.0 million in 1997. Service charges and other fees increased to $612.0 million, or 81%, for the year ended December 31, 1998 compared to $337.8 million for the year ended December 31, 1997. These increases were due to a 39% increase in the average number of accounts for the year ended December 31, 1998, from 1997, an increase in charge volume, a shift to more fee-intensive products and changes in the terms of overlimit fees charged.

Interchange income decreased $2.4 million, or 5%, to $49.0 million for the year ended December 31, 1997, from $51.4 million in 1996 as a result of the securitization of a higher percentage of more fee-intensive other credit card products in 1997 compared to 1996. Service charges and other fees increased to $337.8 million, or 34%, for the year ended December 31, 1997 compared to $252.2 million for the year ended December 31, 1996. This increase was due to a 33% increase in the average number of accounts for the year ended December 31, 1997, from 1996, a shift to more fee-intensive products and changes in the terms of overlimit fees charged.



Non-Interest Expense

Non-interest expense for the year ended December 31, 1998, increased $588.1 million, or 67%, to $1.5 billion from $884.0 million for the year ended December 31, 1997. Contributing to the increase in non-interest expense were marketing expenses which increased $221.4 million, or 98%, to $446.3 million in 1998, from $224.8 million in 1997. The increase in marketing expenses during 1998 reflects the Company's continued identification of and investments in opportunities for growth. Salaries and associate benefits increased $187.1 million, or 65%, to $476.4 million in 1998, from $289.3 million in 1997, as the Company added 4,526 associates to manage the growth in the Company's accounts. This increase also reflects an additional $45.3 million in compensation expense associated with the Company's associate stock plans compared to the prior year. All other non-interest expenses increased $179.6 million, or 49%, to $549.5 million for the year ended December 31, 1998, from $369.8 million in 1997. The increase in other non-interest expense, as well as the increase in salaries and associate benefits not attributable to the Company's associate stock plans, was primarily a result of a 39% increase in the average number of accounts for the year ended December 31, 1998, which resulted in an increase in staff and other operational costs associated with the Company's growth pattern.

Non-interest expense for the year ended December 31, 1997 increased $170.8 million, or 24%, to $884.0 million from $713.2 million for the year ended December 31, 1996. Contributing to the increase in non-interest expense was salaries and associate benefits expense, which increased $74.1 million, or 34%, to $289.3 million in 1997 compared to $215.2 million in 1996. This increase reflected additional staff associated with the cost of operations to manage the growth in accounts and $17.0 million in additional expense associated with the Company's associate stock plans. Also contributing to the increase in non-interest expense was marketing expenses which increased $18.2 million, or 9%, to $224.8 million in 1997, from $206.6 million in 1996. All other non-interest expenses increased $78.4 million, or 27%, to $369.8 million in 1997 compared to $291.4 million in 1996. The increase in other non-interest expenses was primarily the result of a 33% increase in the average number of accounts for the year ended December 31, 1997.

Income Taxes

The Company's income tax rate was 38% for the years ended December 31, 1998 and 1997, and 37.5% for the year ended December 31, 1996. The effective rate includes both state and federal income tax components.

Asset Quality

The asset quality of a portfolio is generally a function of the initial underwriting criteria used, seasoning of the accounts, levels of competition, account management activities and demographic concentration, as well as general economic conditions. Accounts tend to exhibit a rising trend of delinquency and credit losses as they season. As of December 31, 1998 and 1997, 59% and 53% of managed accounts, representing 51% and 43% of the total managed loan balance, respectively, were less than eighteen months old. Accordingly, it is likely that the Company's managed loan portfolio could experience increased levels of delinquency and credit losses as the average age of the Company's accounts increases.

Changes in the rates of delinquency and credit losses can also result from a shift in the product mix. As discussed in "Risk Adjusted Revenue and Margin," certain other customized card products have, in some cases, higher delinquency and higher charge-off rates. In the case of secured card loans, collateral, in the form of cash deposits, reduces any ultimate charge-offs. The costs associated with higher delinquency and charge-off rates are considered in the pricing of individual products.

During 1998, general economic conditions for consumer credit stabilized and improved as industry levels of charge-offs (including bankruptcies) and delinquencies both decreased. These trends have positively impacted the Company's 1998 results.

Delinquencies

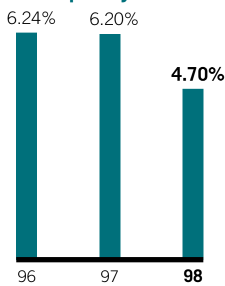
Table 6 shows the Company's consumer loan delinquency trends for the years presented on a reported and managed basis. The entire balance of an account is contractually delinquent if the minimum payment is not received by the payment due date. Delinquencies not only have the potential to impact earnings if the account charges off, they also are costly in terms of the personnel and other resources dedicated to resolving the delinquencies.

The 30-plus day delinquency rate for the reported consumer loan portfolio decreased to 4.70% as of December 31, 1998, from 5.51% as of December 31, 1997. The 30-plus day delinquency rate for the managed consumer loan portfolio was 4.70% as of December 31, 1998, down from 6.20% as of December 31, 1997, while the dollar amount of delinquent managed consumer loans decreased approximately $64.2 million. Both the managed and reported consumer loan portfolio's delinquency rate decreases as of December 31, 1998, principally reflected improvements in consumer credit performance and less seasoned accounts.

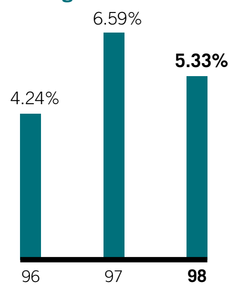
Table 6: Delinquencies

	December 31									
	1998		1997		1996		1995		1994	
(Dollars in Thousands)	**Loans**	**% of Total Loans**	Loans	% of Total Loans	Loans	% of Total Loans	Loans	% of Total Loans	Loans	% of Total Loans
Reported:										
Loans outstanding	**$ 6,157,111**	**100.00%**	$ 4,861,687	100.00%	$ 4,343,902	100.00%	$ 2,921,679	100.00%	$2,228,455	100.00%
Loans delinquent:										
30-59 days	**123,162**	**2.00**	104,216	2.14	96,819	2.23	65,711	2.25	29,032	1.30
60-89 days	**67,504**	**1.10**	64,217	1.32	55,679	1.28	38,311	1.31	14,741	.66
90 or more days	**98,798**	**1.60**	99,667	2.05	111,791	2.57	79,694	2.73	24,445	1.10
Total	**$ 289,464**	**4.70%**	$ 268,100	5.51%	$ 264,289	6.08%	$ 183,716	6.29%	$ 68,218	3.06%
Managed:										
Loans outstanding	**$17,395,126**	**100.00%**	$14,231,015	100.00%	$12,803,969	100.00%	$10,445,480	100.00%	$7,378,455	100.00%
Loans delinquent:										
30-59 days	**329,239**	**1.89**	327,407	2.30	279,787	2.19	165,306	1.58	90,733	1.23
60-89 days	**182,982**	**1.05**	213,726	1.50	162,668	1.27	92,665	.89	45,277	.61
90 or more days	**305,589**	**1.76**	340,887	2.40	356,700	2.78	181,243	1.73	81,720	1.11
Total	**$ 817,810**	**4.70%**	$ 882,020	6.20%	$ 799,155	6.24%	$ 439,214	4.20%	$ 217,730	2.95%

Managed 30+ Day Delinquency Rate



Managed Net Charge-Off Rate



Net Charge-Offs

Net charge-offs include the principal amount of losses (excluding accrued and unpaid finance charges, fees and fraud losses) less current period recoveries. In 1997, the Company modified its methodology for charging off credit card loans (net of any collateral) to 180 days past-due from the prior practice of charging off loans during the next billing cycle after becoming 180 days past-due.

For the year ended December 31, 1998, the managed net charge-off rate decreased 126 basis points to 5.33%. For the year ended December 31, 1998, the reported net charge-off rate decreased 59 basis points to 4.24%. The decreases in managed and reported net charge-off rates were the result of improved

general economic trends in consumer credit performance compared to the prior year, with less of an impact on reported net charge-offs due to the increased level of seasoned and higher yielding products included in the reported portfolio. Table 7 shows the Company's net charge-offs for the years presented on a reported and managed basis.

The Company's objective is to optimize the profitability of each account within acceptable risk characteristics. The Company takes measures as necessary, including requiring collateral on certain accounts and other marketing and account management techniques, to maintain the Company's credit quality standards and to manage the risk of loss on existing accounts. See "Risk Adjusted Revenue and Margin" for further discussion.

Table 7: Net Charge-Offs

	Year Ended December 31				
(Dollars in Thousands)	**1998**	1997	1996	1995	1994
Reported:					
Average loans outstanding	**$ 5,348,559**	$ 4,103,036	$ 3,651,908	$2,940,208	$2,286,684
Net charge-offs	**226,531**	198,192	132,590	59,618	25,727
Net charge-offs as a percentage of average loans outstanding	**4.24%**	4.83%	3.63%	2.03%	1.13%
Managed:					
Average loans outstanding	**$15,209,537**	$13,007,182	$11,268,461	$9,089,278	$6,197,423
Net charge-offs	**810,306**	856,704	477,732	204,828	91,648
Net charge-offs as a percentage of average loans outstanding	**5.33%**	6.59%	4.24%	2.25%	1.48%

Provision and Allowance for Loan Losses

The allowance for loan losses is maintained at the amount estimated to be sufficient to absorb probable future losses, net of recoveries (including recovery of collateral), inherent in the existing reported loan portfolio. The provision for loan losses is the periodic cost of maintaining an adequate allowance. Management believes that the allowance for loan losses is adequate to cover anticipated losses in the reported homogeneous consumer loan portfolio under current conditions. There can be no assurance as to future credit losses that may be incurred in connection with the Company's consumer loan portfolio, nor can there be any assurance that the loan loss allowance that has been established by the Company will be sufficient to absorb such future credit losses. The allowance is a general allowance applicable to the reported consumer loan portfolio. Additional information on the Company's allowance for loan loss policy can be found in Note A to the Consolidated Financial Statements. Table 8 sets forth the activity in the allowance for loan losses for the periods indicated. See "Asset Quality," "Delinquencies" and "Net Charge-Offs" for a more complete analysis of asset quality.

Table 8: Summary of Allowance for Loan Losses

	Year Ended December 31				
(Dollars in Thousands)	**1998**	1997	1996	1995	1994
Balance at beginning of year	**$ 183,000**	$ 118,500	$ 72,000	$ 68,516	$ 63,516
Provision for loan losses	**267,028**	262,837	167,246	65,895	30,727
Acquisitions/other	**7,503**	(2,770)	(18,887)	(11,504)	(4,869)
Charge-offs	**(294,295)**	(223,029)	(115,159)	(64,260)	(31,948)
Recoveries	**67,764**	27,462	13,300	13,353	11,090
Net charge-offs	**(226,531)**	(195,567)	(101,859)	(50,907)	(20,858)
Balance at end of year	**$ 231,000**	$ 183,000	$ 118,500	$ 72,000	$ 68,516
Allowance for loan losses to loans at end of year	**3.75%**	3.76%	2.73%	2.86%	3.07%

For the year ended December 31, 1998, the provision for loan losses increased to $267.0 million, or 2%, from the 1997 provision for loan losses of $262.8 million as average reported loans increased by 30%, offset by general improvements in consumer credit performance. The Company increased the allowance for loan losses by $48.0 million during 1998 primarily due to the growth in reported loans.

For the year ended December 31, 1997, the provision for loan losses increased to $262.8 million, or 57%, from the 1996 provision for loan losses of $167.2 million. The allowance for loan losses as a percentage of reported consumer loans increased to 3.76% as of December 31, 1997, from 2.73% as of December 31, 1996 primarily due to increases in the net charge-off rate to 4.83% for 1997, from 3.63% in 1996, resulting from continued loan seasoning, general economic trends in consumer credit performance and the modification in charge-off policy described earlier. The provision increase also reflected the increase in reported consumer loans to $4.9 billion as of December 31, 1997, an increase of

12% from December 31, 1996, and the continued growth of other customized card products. In consideration of these factors, the Company increased the allowance for loan losses by $64.5 million during 1997.

Funding

The Company has established access to a wide range of domestic funding alternatives, in addition to securitization of its consumer loans. The Company primarily issues senior unsecured debt of the Bank through its $8.0 billion bank note program, of which $3.4 billion was outstanding as of December 31, 1998, with original terms of one to ten years. During 1998, the Bank continued to expand its fixed income investor base by launching $300 million five-year and $200 million ten-year benchmark underwritten senior note transactions, followed by additional issuances in response to investor interest. The Corporation also continued to access the capital markets with a $200 million ten-year senior note.

Internationally, the Company has funding programs designed for foreign investors or to raise funds in foreign currencies. The Company has accessed the international securitization market for a number of years with both US$ and foreign denominated transactions. Both of the Company's committed revolving credit facilities offer foreign currency funding options. The Bank has established a $1.0 billion Euro Debt Issuance program that is targeted to non-U.S. investors. The Company funds its foreign assets by directly or synthetically borrowing or securitizing in the local currency to mitigate the financial statement effect of currency translation.

The Company has significantly expanded its retail deposit gathering efforts through both direct and broker marketing channels. The Company uses its IBS capabilities to test and market a variety of retail deposit origination strategies, as well as to develop customized account management programs. As of December 31, 1998, the Company had $2.0 billion in interest-bearing deposits, with original maturities up to five years.

Table 9 reflects the costs of other borrowings of the Company as of and for each of the years ended December 31, 1998, 1997 and 1996.

Table 9: Other Borrowings

(Dollars in Thousands)	Maximum Outstanding as of any Month-End	Outstanding as of Year-End	Average Outstanding	Average Interest Rate	Year-End Interest Rate
1998					
Federal funds purchased and resale agreements	**$1,451,029**	**$1,227,000**	**$1,169,952**	**6.09%**	**5.53%**
Other	**417,279**	**417,279**	**206,204**	**8.44**	**6.58**
Total		**$1,644,279**	**$1,376,156**	**6.44%**	**5.80%**
1997					
Federal funds purchased and resale agreements	$ 999,200	$ 705,863	$ 503,843	5.54%	5.75%
Other	160,144	90,249	128,033	8.71	7.09
Total		$ 796,112	$ 631,876	6.18%	5.90%
1996					
Federal funds purchased and resale agreements	$ 617,303	$ 445,600	$ 342,354	5.63%	6.26%
Other	207,689	85,383	112,545	8.20	6.43
Total		$ 530,983	$ 454,899	6.27%	5.29%

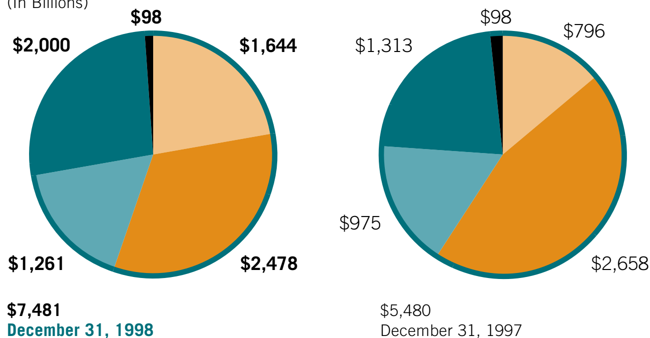


Table 10 shows the maturities of certificates of deposit in denominations of $100,000 or greater (large denomination CDs) as of December 31, 1998.

Table 10: Maturities of Domestic Large Denomination Certificates — $100,000 or More

	December 31, 1998	
(Dollars in Thousands)	Balance	Percent
3 months or less	**$ 66,174**	**14.67%**
Over 3 through 6 months	**36,730**	**8.14**
Over 6 through 12 months	**88,889**	**19.71**
Over 12 months	**259,283**	**57.48**
Total	**$451,076**	**100.00%**

Additional information regarding funding can be found in Note E to the Consolidated Financial Statements.

Liquidity

Liquidity refers to the Company's ability to meet its cash needs. The Company meets its cash requirements by securitizing assets and through issuing debt. As discussed in "Managed Consumer Loan Portfolio," a significant source of liquidity for the Company has been the securitization of consumer loans. Maturity terms of the existing securitizations vary from 1999 to 2008 and typically have accumulation periods during which principal payments are aggregated to make payments to investors. As payments on the loans are accumulated and are no longer reinvested in new loans, the Company's funding requirements for such new loans increase accordingly. The occurrence of certain events may cause the securitization transactions to amortize earlier than scheduled, which would accelerate the need for funding.

Table 11 shows the amounts of investor principal from securitized consumer loans that are expected to amortize, or be otherwise paid over the periods indicated, based on outstanding securitized consumer loans as of January 1, 1999. As of December 31, 1998 and 1997, 65% and 66%, respectively, of the Company's total managed loans were securitized.

As such amounts amortize or are otherwise paid, the Company believes it can securitize consumer loans, purchase federal funds and establish other funding sources to fund the amortization or other payment of the securitizations in the future, although no assurance can be given to that effect. Additionally, the Company maintains a portfolio of high-quality securities such as U.S. Treasuries and other U.S. government obligations, commercial paper, interest-bearing deposits with other banks, federal funds and other cash equivalents in order to provide adequate liquidity and to meet its ongoing cash needs. As of December 31, 1998, the Company had $2.1 billion of such securities.

Liability liquidity is measured by the Company's ability to obtain borrowed funds in the financial markets in adequate amounts and at favorable rates. As of December 31, 1998, the Company, the Bank and the Savings Bank collectively had over $1.9 billion in unused commitments, under its credit facilities, available for liquidity needs.

Table 11: Securitizations—Amortization Table

(Dollars in Thousands)	1999	2000	2001	2002	2003-2008
Balance at beginning of year	$11,742,081	$ 9,766,447	$ 7,260,833	$ 3,758,706	$ 2,126,356
Less repayment amounts	(1,975,634)	(2,505,614)	(3,502,127)	(1,632,350)	(2,126,356)
Balance at end of year	$ 9,766,447	$ 7,260,833	$ 3,758,706	$ 2,126,356	$ —

Capital Adequacy

The Bank and the Savings Bank are subject to capital adequacy guidelines adopted by the Federal Reserve Board (the "Federal Reserve") and the Office of Thrift Supervision (the "OTS") (collectively, the "regulators"), respectively. The capital adequacy guidelines and the regulatory framework for prompt corrective action require the Bank and the Savings Bank to maintain specific capital levels based upon quantitative measures of their assets, liabilities and off-balance sheet items.

The most recent notifications received from the regulators categorized the Bank and the Savings Bank as "well-capitalized." As of December 31, 1998, there are no conditions or events since the notifications discussed above that management believes have changed either the Bank or the Savings Bank's capital category.

During 1996, the Bank received regulatory approval and established a branch office in the United Kingdom. In connection with such approval, the Company committed to the Federal Reserve that, for so long as the Bank maintains a branch in the United Kingdom, the Company will maintain a minimum Tier 1 Leverage ratio of 3.0%. As of December 31, 1998 and 1997, the Company's Tier 1 Leverage ratio was 13.49% and 13.83%, respectively.

Additional information regarding capital adequacy can be found in Note K to the Consolidated Financial Statements.

In July 1997, the Company's Board of Directors voted to repurchase up to two million shares of the Company's common stock over the next two years to mitigate the dilutive impact of shares issuable under its benefit plans, including its Associate Stock Purchase Plan, dividend reinvestment plan and stock incentive plans. In July 1998, the Company's Board of Directors voted to increase this amount by an additional 1.5 million shares of the Company's common stock. The Company uses various strategies to reduce the cost of its share repurchase program, including the writing of put options on anticipated repurchases. For the years ended December 31, 1998 and 1997, the Company repurchased 895,800 and 1,318,641 shares, respectively, under this program. Certain treasury shares were reissued in connection with the Company's benefit plans.

Dividend Policy

Although the Company expects to reinvest a substantial portion of its earnings in its business, the Company intends to continue to pay regular quarterly cash dividends on the Common Stock. The declaration and payment of dividends, as well as the amount thereof, is subject to the discretion of the Board of Directors of the Company and will depend upon the Company's results of operations, financial condition, cash requirements, future prospects and other factors deemed relevant by the Board of Directors. Accordingly, there can be no assurance that the Corporation will declare and pay any dividends. As a holding company, the ability of the Company to pay dividends is dependent upon the receipt of dividends or other payments from its subsidiaries. Applicable banking regulations and provisions that may be contained in borrowing agreements of the Company or its subsidiaries may restrict the ability of the Company's subsidiaries to pay dividends to the Corporation or the ability of the Corporation to pay dividends to its stockholders.

Off-Balance Sheet Risk

The Company is subject to off-balance sheet risk in the normal course of business including commitments to extend credit, reduce the interest rate sensitivity of its securitization transactions and its off-balance sheet financial instruments. The Company enters into interest rate swap agreements in the management of its interest rate exposure. The Company also enters into forward foreign currency exchange contracts and currency swaps to reduce its sensitivity to changing foreign currency exchange rates. These off-balance sheet financial instruments involve elements of credit, interest rate or foreign currency exchange rate risk in excess of the amount recognized on the balance sheet. These instruments also present the Company with certain credit, market, legal and operational risks. The Company has established credit policies for off-balance sheet instruments as it has for on-balance sheet instruments.

Additional information regarding off-balance sheet financial instruments can be found in Note O to the Consolidated Financial Statements.

Interest Rate Sensitivity

Interest rate sensitivity refers to the change in earnings that may result from changes in the level of interest rates. To the extent that managed interest income and expense do not respond equally to changes in interest rates, or that all rates do not change uniformly, earnings could be affected. The Company's managed net interest income is affected by changes in short-term interest rates, primarily LIBOR, as a result of its issuance of interest-bearing deposits, variable rate loans and variable rate securitizations. 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 entering into interest rate swaps.

The Company measures exposure to its interest rate risk through the use of a simulation model. The model generates a distribution of possible twelve-month managed net interest income outcomes based on (i) a set of plausible interest rate scenarios, as determined by management based upon historical trends and market expectations, (ii) all existing financial instruments, including swaps, and (iii) an estimate of ongoing business activity over the coming twelve months. The Company's asset/liability management policy requires that based on this distribution there be at least a 95% probability that managed net interest income achieved over the coming twelve months will be no more than 3% below the mean managed net interest income of the distribution. As of December 31, 1998, the Company was in compliance with the policy; more than 95% of the outcomes generated by the model produced a managed net interest income of no more than 1.8% below the mean outcome. The interest rate scenarios evaluated as of December 31, 1998, included scenarios in which short-term interest rates rose by as much as 400 basis points or fell by as much as 175 basis points over twelve months.

The analysis does not consider the effects of the changed level of overall economic activity associated with various interest rate scenarios. Further, in the event of a rate change of large magnitude, management would likely take actions to further mitigate its exposure to any adverse impact. For example, management may reprice interest rates on outstanding credit card loans subject to the right of the consumers in certain states to reject such repricing by giving timely written notice to the Company and thereby relinquishing charging privileges. However, the repricing of credit card loans may be limited by competitive factors as well as certain legal constraints.

Interest rate sensitivity at a point in time can also be analyzed by measuring the mismatch in balances of earning assets and interest-bearing liabilities that are subject to repricing in future periods.

Table 12 reflects the interest rate repricing schedule for earning assets and interest-bearing liabilities as of December 31, 1998.

Table 12: Interest Rate Sensitivity

	As of December 31, 1998, Subject to Repricing			
(Dollars in Millions)	Within 180 Days	>180 Days- 1 Year	>1 Year- 5 Years	Over 5 Years
Earning assets:				
Federal funds sold and resale agreements	$ 262			
Interest-bearing deposits at other banks	22			
Securities available for sale	148	$ 95	$ 1,082	$ 472
Consumer loans	3,111	161	2,885	
Total earning assets	3,543	256	3,967	472
Interest-bearing liabilities:				
Deposits	1,019	243	738	
Other borrowings	1,644			
Senior and deposit notes	467	470	2,123	679
Total interest-bearing liabilities	3,130	713	2,861	679
Non-rate related net assets				(855)
Interest sensitivity gap	413	(457)	1,106	(1,062)
Impact of swaps	3,264	(138)	(2,119)	(1,007)
Impact of consumer loan securitizations	(3,847)	(493)	4,966	(626)
Interest sensitivity gap adjusted for impact of securitizations and swaps	$ (170)	$(1,088)	$ 3,953	$(2,695)
Adjusted gap as a percentage of managed assets	(.82)%	(5.28)%	19.17%	(13.07)%
Adjusted cumulative gap	$ (170)	$(1,258)	$ 2,695	
Adjusted cumulative gap as a percentage of managed assets	(.82)%	(6.10)%	13.07%	0.00 %

Business Outlook

Earnings, Goals and Strategies

This business outlook section summarizes the Company's expectations for earnings for the year ending December 31, 1999, and its primary goals and strategies for continued growth. The statements contained in this section are based on management's current expectations. Certain statements are forward looking and, therefore, actual results could differ materially. Factors which could materially influence results are set forth throughout this section and in the Company's Annual Report on Form 10-K for the year ended December 31, 1998 (Part I, Item 1, Risk Factors).

The Company has set an earnings target increase of approximately 30% over 1998 earnings and a return on equity in excess of 20%. As discussed elsewhere in this report and below, the Company's actual earnings are a function of its revenues (net interest income and non-interest income on its earning assets), consumer usage and payment patterns, credit quality of its earning assets (which affects fees and charge-offs), marketing expenses and operating expenses.

Product and Market Opportunities

The Company's strategy for future growth has been, and is expected to continue to be, to apply its proprietary IBS to its lending business as well as to other businesses, both financial and non-financial, including telecommunications services. The Company will seek to identify new product opportunities and to make informed investment decisions regarding new and existing products. The Company's lending and other financial and non-financial products are subject to competitive pressures, which management anticipates will increase as these markets mature.

Lending Lending includes credit card and other consumer lending products. Credit card opportunities include, and are expected to continue to include, low introductory and intermediate rate balance transfer products, low non-introductory rate products, as well as other customized credit card products, such as secured cards, affinity and co-branded cards, student cards and other cards tailored for specific consumer segments. The Company expects continued growth across a broad spectrum of new and existing customized products, which are distinguished by a varied range of credit lines, pricing structures and other characteristics. For example, the Company's low non-introductory rate products, which are marketed to consumers with the best established credit profiles, are characterized by higher credit lines, lower yields and an expectation of lower delinquencies and credit losses than the traditional low introductory rate balance transfer products. On the other hand, certain other customized card products are characterized by lower credit lines, higher yields (including fees) and in some cases,

higher delinquencies and credit losses than the Company's traditional products. These products also involve higher operational costs but exhibit better response rates, less adverse selection, less attrition and a greater ability to reprice than the Company's traditional introductory rate products. More importantly, as a whole, all of these customized products continue to have less volatile returns than the traditional products in recent market conditions.

On July 31, 1998, the Company completed the acquisition of Summit Acceptance Corporation ("Summit"), a Texas corporation. Summit is an indirect automobile finance lender located in Dallas, Texas. Summit is the Company's platform to test and apply its IBS to the automobile loan market.

Telecommunications The Company expects to continue its efforts to market telecommunications services through its subsidiary America One Communications, Inc. ("America One"). America One's initial business, the reselling of wireless services through direct marketing channels, has recently begun to experience growth in the number of customers and accounts. As a result of the expenses necessary to build the operations to support this new business and to acquire new accounts, to date this business negatively impacts earnings.

International Expansion The Company has expanded its existing operations outside of the United States, with an initial focus on the United Kingdom and Canada. The Company has experienced growth in the number of accounts and loan balances in its international business. To support the continued growth of its United Kingdom business and any future business in Europe, in July 1998, the Company opened a new operations center in Nottingham, England.

The Company will continue to apply its IBS in an effort to balance the mix of credit card products with other financial and non-financial products and services to optimize profitability within the context of acceptable risk. The Company's growth through expansion and product diversification will be affected by the ability to internally build or acquire the necessary operational and organizational infrastructure, recruit experienced personnel and fund these new businesses. Although management believes it has the personnel, financial resources and business strategy necessary for continued success, there can be no assurance that the Company's historical financial performance will necessarily reflect its results of operations and financial condition in the future.

Marketing Investment

The Company expects its 1999 marketing expenses to exceed 1998's expense level, as the Company continues to invest in its various credit card products and services, and other financial and non-financial products and services. The Company cautions, however, that an increase in marketing expenses does not necessarily equate to a comparable increase in outstanding balances or accounts based on historical results. As the Company's portfolio continues to increase, additional growth to offset attrition requires increasing amounts of marketing. Intense competition in the credit card market has resulted in a decrease in credit card response rates and reduced productivity of marketing dollars invested in certain lines of business. In addition, the cost to acquire new accounts varies across product lines. With competition affecting the profitability of existing introductory rate card products, the Company has been allocating, and expects to continue to allocate, a greater portion of its marketing expense to other customized credit card products and other financial and non-financial products. Additionally, the cost to acquire an America One wireless account includes the cost of providing a free phone to the customer, and consequently is substantially more than the cost to acquire a credit card account. The Company intends to continue a flexible approach in its allocation of marketing expenses. The actual amount of marketing investment is subject to a variety of external and internal factors, such as competition in the consumer credit industry, general economic conditions affecting consumer credit performance, the asset quality of the Company's portfolio and the identification of market opportunities across product lines that exceed the Company's targeted rates of return on investment.

The amount of marketing expense allocated to various product segments will influence the characteristics of the Company's portfolio as the various product segments are characterized by different account growth, loan growth and asset quality characteristics. The Company currently expects continued strong account growth and loan growth in 1999. Actual growth, however, may vary significantly depending on the Company's actual product mix and the level of attrition on the Company's managed portfolio, which is primarily affected by competitive pressures.

Impact of Delinquencies, Charge-Offs and Attrition

The Company's earnings are particularly sensitive to delinquencies and charge-offs on the Company's portfolio and on the level of attrition due to competition in the credit card industry. As delinquency levels fluctuate, the resulting amount of past-due and overlimit fees, which are significant sources of revenue for the Company, will also fluctuate. Further, the timing of revenues from increasing or decreasing delinquencies precedes the related impact of higher or lower charge-offs that ultimately result from varying levels of delinquencies. Delinquencies and net charge-offs are impacted by general economic trends in consumer credit performance, including bankruptcies, the continued seasoning of the Company's portfolio and the product mix.

The Company's expectations for 1999 earnings are based on management's belief that consumer credit quality is stabilizing. Management expects that during the first half of 1999 delinquencies and charge-offs will remain stable. Management, however, cautions that delinquency and charge-off levels are not always predictable and may vary from projections. In the case of an economic downturn or recession, delinquencies and charge-offs are likely to increase. In addition, competition in the credit card industry, as measured by the volume of mail solicitations, remains very high. Increased competition can affect the Company's earnings by increasing attrition of the Company's outstanding loans (thereby reducing interest and fee income) and by making it more difficult to retain and attract more profitable customers.

Year 2000

The Year 2000 Issue and the Company's State of Readiness The year 2000 problem is a result of computer systems using two digits rather than four digits to define an applicable year. The Company utilizes a significant number of internal computer software programs and operating systems across its entire organization. In addition, the Company depends on its external business vendors to provide external services for its operations. To the extent the software applications of the Company or its vendors contain codes that are unable to appropriately interpret the year 2000 and beyond, some level of modification, or even possibly replacement of such applications, may be necessary.

In October 1996, the Company formed a year 2000 project office to identify software systems and computer-related devices that required modification for the year 2000. Shortly after its inception, the project office developed its strategy for the Company's information technology computer-based systems. This strategy is based, in large part, on the regulatory guidelines published by the Federal Financial Institutions Examination Counsel. This strategy calls for five milestones:

- awareness of the existence of information technology systems Company-wide;
- assessment of those systems for year 2000 readiness;
- renovation of those systems and their date coding functions;
- validation (testing) of renovations; and
- implementation of all renovations made.

To implement this strategy, the Company categorized its information technology ("IT") systems into year 2000 projects and by domestic lending, United Kingdom operations, America One and Summit. Approximately 63% of the projects have completed all milestones, which includes substantially all of the Company's mission critical systems. Another 22% are in the *validation* and *implementation* stages, and the remaining 15% are in the *assessment* and *renovation* stages. The Company expects to complete all project milestones by the end of the second quarter of 1999. This is a change from the previously projected date of the end of the first quarter of 1999 and is largely due to Summit and the United Kingdom projects. In addition to these milestones, throughout 1999, the Company will conduct an internal audit certification of its testing measures and, for systems with cross functionality, perform integrated testing.

The Company is also addressing the effect of the year 2000 on other non-IT systems, which are not included as part of the IT project areas set forth above. These non-IT systems primarily consist of desk top computer applications used by the Company's associates. The Company has inventoried and assessed these applications and expects to complete renovations by the end of the second quarter of 1999, a change from the original projected completion of the end of the first quarter of 1999.

In addition, the Company utilizes outside business vendors in its day-to-day operations and is assessing the overall year 2000 readiness of its external business vendors and year 2000 compliance of specific vendor systems used in the Company's operations. These vendors include credit bureaus, collection agencies, utilities and other related service providers, third party processors, the U.S. postal service, telephone companies, technology vendors, and banks that are creditors of the Company or which provide cash management, trustee, paying agent, stock transfer agent or other services. These vendors also include third parties that the Company uses to outsource certain operations for America One, the United Kingdom and Summit. In assessing overall compliance, the Company requests information from its vendors about their actions to become year 2000 compliant, placing extensive focus on its high priority vendors. The Company, however, must rely on the actions of and the information provided by its vendors and cannot guarantee that vendor systems will, in fact, be compliant. For high priority vendors that the Company determines may not be taking appropriate and timely action or have failed to provide sufficient information, the Company will accelerate contingency planning efforts. The Company has increased its contingency efforts to accelerate the vendors' compliance efforts and/or internally build systems for America One's billing systems and the UK and Summit account processing systems. The Company will continue to actively monitor the efforts of all of its vendors and take actions to mitigate year 2000 issues resulting from any failure of its vendors to be year 2000 compliant.

The Company's Contingency Plan The Company has established contingency planning projects for its critical business units. The Company's general contingency planning strategy has been refined to include the achievement of four milestones: (i) inventory and assessment of year 2000 risks, (ii) business impact analysis, (iii) developing contingency plans to mitigate the risks, and (iv) testing and validation of these contingency plans. The Company has completed all of the inventory and assessment milestones and a large majority of the business impact analysis milestones for all of its domestic lending and America One projects. The Company expects all of its domestic lending plans to be developed by the end of the first quarter of 1999, with testing and validation to be ongoing throughout the year. The Company has increased its contingency planning efforts for its United Kingdom operations and for Summit and America One. The Company will be developing these contingency planning efforts throughout 1999, and anticipates that the execution of those plans will be completed in the fourth quarter of 1999, with testing and validation to be ongoing.

The Costs to Address the Company's Year 2000 Issues As of December 31, 1998, the Company had spent approximately $5.5 million for year 2000 remediation of its IT systems. The Company estimates that it will incur an additional $1.5 million in 1999. This includes an increase of approximately $1.0 million from previous estimates primarily due to accelerated contingency planning for America One. In addition, the Company estimates that it will incur an additional $2.0 million in 1999, which represents the early purchase of systems which will be used to conduct its integrated testing. Costs associated with non-IT systems, which are not included, are not expected to be material.

The Risks of the Company's Year 2000 Issues Although the Company expects to have all of its system modifications completed and tested extensively by the onset of the new millennium, unforeseen problems could arise from not being year 2000 compliant. The Company's business is heavily reliant on computer technologies and problems could arise resulting in delays and malfunctions that may impact the Company's operations, liquidity and financial results. In addition, the Company cannot guarantee that all of its vendors will have completed system renovations and be compliant by the year 2000. Although the Company is developing contingency plans to mitigate the risks from third party vendors and systems, the failure of third parties to provide the Company with products, services or systems that meet year 2000 requirements could materially impact the Company's business and operations. For example, failure of the U.S. postal service, the Company's local and long distance carriers or its material third party processors to be year 2000 compliant could cause disruption or delay in the Company's ability to solicit new customers and service the accounts of its existing customers.

The estimated year 2000 costs and the Company's expectations that its systems, and those of its third party partners and vendors, will be year 2000 compliant are forward looking statements. These statements are based on management's reasonable estimates and assumptions about future events and are subject to risks and uncertainties. Although the Company believes it has taken the necessary precautionary measures to assure the year 2000 will not adversely affect its business, there is no guarantee that the Company's year 2000 expectations will be achieved and actual results could differ materially.

Cautionary Factors

The Company's strategies and objectives outlined above, and the other forward looking statements contained in this section, involve a number of risks and uncertainties. The Company cautions readers that any forward looking information is not a guarantee of future performance and that actual results could differ materially. In addition to the factors discussed above, among the other factors that could cause actual results to differ materially are the following: continued intense competition from numerous providers of products and services which compete with the Company's businesses; with respect to financial products, changes in the Company's aggregate accounts or consumer loan balances and the growth rate thereof, including changes resulting from factors such as shifting product mix, amount of actual marketing expenses made by the Company and attrition of accounts and loan balances; an increase in credit losses (including increases due to a worsening of general economic conditions); the ability of the Company to continue to securitize its credit cards and consumer loans and to otherwise access the capital markets at attractive rates and terms to fund its operations and future growth; difficulties or delays in the development, production, testing and marketing of new products or services; losses associated with new products or services or expansion internationally; financial, legal, regulatory or other difficulties that may affect investment in, or the overall performance of, a product or business, including changes in existing laws to regulate further the credit card and consumer loan industry and the financial services industry, in general; the amount of, and rate of growth in, the Company's expenses (including salaries and associate benefits and marketing expenses) as the Company's business develops or changes or as it expands into new market areas; the availability of capital necessary to fund the Company's new businesses; the ability of the Company to build the operational and organizational infrastructure necessary to engage in new businesses or to expand internationally; the ability of the Company to recruit experienced personnel to assist in the management and operations of new products and services; the ability of the Company and its suppliers to successfully address year 2000 compliance issues; and other factors listed from time to time in the Company's SEC reports, including, but not limited to, the Annual Report on Form 10-K for the year ended December 31, 1998 (Part I, Item 1, Risk Factors).

Selected Quarterly Financial Data

(Unaudited)	1998 Fourth Quarter	1998 Third Quarter	1998 Second Quarter	1998 First Quarter	1997 Fourth Quarter[1]	1997 Third Quarter	1997 Second Quarter	1997 First Quarter
Summary Of Operations (In Thousands):								
Interest income	**$298,947**	**$283,109**	**$271,438**	**$258,042**	$203,551	$178,970	$166,870	$168,594
Interest expense	**115,765**	**106,055**	**101,714**	**93,220**	89,023	81,816	83,611	80,397
Net interest income	**183,182**	**177,054**	**169,724**	**164,822**	114,528	97,154	83,259	88,197
Provision for loan losses	**54,580**	**67,569**	**59,013**	**85,866**	94,356	72,518	46,776	49,187
Net interest income after provision for loan losses	**128,602**	**109,485**	**110,771**	**78,956**	20,172	24,636	36,483	39,010
Non-interest income	**456,476**	**386,955**	**328,953**	**315,899**	316,098	280,933	229,042	243,057
Non-interest expense	**467,870**	**383,527**	**331,836**	**288,883**	242,373	226,003	202,055	213,547
Income before income taxes	**117,208**	**112,913**	**107,828**	**105,972**	93,897	79,566	63,470	68,520
Income taxes	**44,539**	**42,907**	**40,975**	**40,269**	35,680	30,236	24,118	26,038
Net income	**$ 72,669**	**$ 70,006**	**$ 66,853**	**$ 65,703**	$ 58,217	$ 49,330	$ 39,352	$ 42,482
Per Common Share:								
Basic earnings	**$ 1.11**	**$ 1.07**	**$ 1.02**	**$ 1.00**	$ .89	$ .75	$ .59	$ .64
Diluted earnings	**1.04**	**1.00**	**.96**	**.96**	.86	.73	.58	.63
Dividends	**.08**	**.08**	**.08**	**.08**	.08	.08	.08	.08
Market prices								
High	**125 7/16**	**129 15/16**	**125 3/8**	**81 7/8**	54 3/16	45 3/4	39 7/8	43 5/8
Low	**51 3/4**	**83**	**82 5/16**	**50 9/16**	44 1/8	32 13/16	31 3/8	33 1/4
Average common shares (000s)	**65,663**	**65,726**	**65,537**	**65,428**	65,535	66,185	66,428	66,336
Average common and common equivalent shares (000s)	**69,685**	**70,012**	**69,527**	**68,415**	67,532	67,574	67,608	67,704
Average Balance Sheet Data: (In Millions)								
Consumer loans	**$ 5,758**	**$ 5,623**	**$ 5,213**	**$ 4,786**	$ 4,508	$ 3,847	$ 3,997	$ 4,059
Allowance for loan losses	**(231)**	**(216)**	**(213)**	**(197)**	(174)	(123)	(119)	(120)
Securities	**2,155**	**1,626**	**1,826**	**1,922**	1,831	1,690	1,563	1,521
Other	**1,511**	**1,473**	**1,280**	**1,025**	899	1,143	1,117	939
Total assets	**$ 9,193**	**$ 8,506**	**$ 8,106**	**$ 7,536**	$ 7,064	$ 6,557	$ 6,558	$ 6,399
Interest-bearing deposits	**$ 1,886**	**$ 1,369**	**$ 1,193**	**$ 1,266**	$ 1,172	$ 852	$ 818	$ 993
Other borrowings	**1,606**	**1,496**	**1,319**	**1,077**	823	595	695	411
Senior and deposit notes	**3,742**	**3,819**	**3,906**	**3,683**	3,614	3,686	3,769	3,809
Other liabilities	**649**	**575**	**553**	**462**	465	485	380	357
Preferred beneficial interests	**98**	**98**	**98**	**98**	98	98	98	65
Stockholders' equity	**1,212**	**1,149**	**1,037**	**950**	892	841	798	764
Total liabilities and stockholders' equity	**$ 9,193**	**$ 8,506**	**$ 8,106**	**$ 7,536**	$ 7,064	$ 6,557	$ 6,558	$ 6,399

The above schedule is a tabulation of the Company's unaudited quarterly results for the years ended December 31, 1998 and 1997. The Company's common shares are traded on the New York Stock Exchange under the symbol COF. In addition, shares may be traded in the over-the-counter stock market. There were 9,692 and 10,585 common stockholders of record as of December 31, 1998 and 1997, respectively.

(1) Includes the effect of the modifications in charge-off policy and finance charge and fee income recognition which reduced interest income by $24.4 million and non-interest income by $48.9 million. See Note A to Consolidated Financial Statements.

Management's Report on Consolidated Financial Statements and Internal Controls Over Financial Reporting

The Management of Capital One Financial Corporation is responsible for the preparation, integrity and fair presentation of the financial statements and footnotes contained in this Annual Report. The Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles and are free of material misstatement. The Company also prepared other information included in this Annual Report and is responsible for its accuracy and consistency with the financial statements. In situations where financial information must be based upon estimates and judgments, they represent the best estimates and judgments of Management.

The Consolidated Financial Statements have been audited by the Company's independent public accountants, Ernst & Young LLP, whose independent professional opinion appears separately. Their audit provides an objective assessment of the degree to which the Company's Management meets its responsibility for financial reporting. Their opinion on the financial statements is based on auditing procedures which include reviewing accounting systems and internal controls and performing selected tests of transactions and records as they deem appropriate. These auditing procedures are designed to provide reasonable assurance that the financial statements are free of material misstatement.

Management depends on its accounting systems and internal controls in meeting its responsibilities for reliable financial statements. In Management's opinion, these systems and controls provide reasonable assurance that assets are safeguarded and that transactions are properly recorded and executed in accordance with Management's authorizations. As an integral part of these systems and controls, the Company maintains a professional staff of internal auditors that conducts operational and special audits and coordinates audit coverage with the independent auditors.

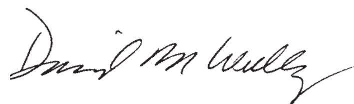
The Audit Committee of the Board of Directors, composed solely of outside directors, meets periodically with the internal auditors, the independent auditors and Management to review the work of each and ensure that each is properly discharging its responsibilities. The independent auditors have free access to the Committee to discuss the results of their audit work and their evaluations of the adequacy of accounting systems and internal controls and the quality of financial reporting.

There are inherent limitations in the effectiveness of internal controls, including the possibility of human error or the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurance with respect to reliability of financial statements and safeguarding of assets. Furthermore, because of changes in conditions, internal control effectiveness may vary over time.

The Company assessed its internal controls over financial reporting as of December 31, 1998, in relation to the criteria described in the "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, the Company believes that as of December 31, 1998, in all material respects, the Company maintained effective internal controls over financial reporting.

Richard D. Fairbank
Chairman and Chief Executive Officer

Nigel W. Morris
President and Chief Operating Officer



David M. Willey
Senior Vice President, Finance and Accounting

Report of Independent Auditors

The Board of Directors and Stockholders
Capital One Financial Corporation

We have audited the accompanying consolidated balance sheets of Capital One Financial Corporation as of December 31, 1998 and 1997, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Capital One Financial Corporation at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

As discussed in Note A to the consolidated financial statements, in 1997 the Company adopted Statement of Financial Accounting Standards No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities."

Washington, D.C.
January 19, 1999

Consolidated Balance Sheets

(Dollars in Thousands, Except Per Share Data)	December 31 1998	1997
Assets:		
Cash and due from banks	**$ 15,974**	$ 5,039
Federal funds sold and resale agreements	**261,800**	173,500
Interest-bearing deposits at other banks	**22,393**	59,184
Cash and cash equivalents	**300,167**	237,723
Securities available for sale	**1,796,787**	1,242,670
Consumer loans	**6,157,111**	4,861,687
Less: Allowance for loan losses	**(231,000)**	(183,000)
Net loans	**5,926,111**	4,678,687
Premises and equipment, net	**242,147**	162,726
Interest receivable	**52,917**	51,883
Accounts receivable from securitizations	**833,143**	588,781
Other	**268,131**	115,809
Total assets	**$9,419,403**	$7,078,279
Liabilities:		
Interest-bearing deposits	**$1,999,979**	$1,313,654
Other borrowings	**1,644,279**	796,112
Senior notes	**3,739,393**	3,332,778
Deposit notes		299,996
Interest payable	**91,637**	68,448
Other	**575,788**	276,368
Total liabilities	**8,051,076**	6,087,356
Commitments and Contingencies		
Guaranteed Preferred Beneficial Interests In Capital One Bank's Floating Rate Junior Subordinated Capital Income Securities:	**97,921**	97,664
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 300,000,000 shares, 66,556,792 and 66,557,230 issued as of December 31, 1998 and 1997, respectively	**666**	666
Paid-in capital, net	**599,498**	513,561
Retained earnings	**679,838**	425,140
Cumulative other comprehensive income	**60,655**	2,539
Less: Treasury stock, at cost; 896,970 and 1,188,134 shares as of December 31, 1998 and 1997, respectively	**(70,251)**	(48,647)
Total stockholders' equity	**1,270,406**	893,259
Total liabilities and stockholders' equity	**$9,419,403**	$7,078,279

See Notes to Consolidated Financial Statements.

Consolidated Statements of Income

(In Thousands, Except Per Share Data)	Year Ended December 31 1998	1997	1996
Interest Income:			
Consumer loans, including fees	**$1,003,122**	$ 619,785	$ 592,088
Federal funds sold and resale agreements	**12,564**	16,423	21,293
Other	**95,850**	81,777	47,102
Total interest income	**1,111,536**	717,985	660,483
Interest Expense:			
Deposits	**67,479**	41,932	56,272
Other borrowings	**88,600**	39,066	28,509
Senior and deposit notes	**260,675**	253,849	210,218
Total interest expense	**416,754**	334,847	294,999
Net interest income	**694,782**	383,138	365,484
Provision for loan losses	**267,028**	262,837	167,246
Net interest income after provision for loan losses	**427,754**	120,301	198,238
Non-Interest Income:			
Servicing and securitizations	**789,844**	682,345	459,833
Service charges and other fees	**611,958**	337,755	252,192
Interchange	**86,481**	49,030	51,399
Total non-interest income	**1,488,283**	1,069,130	763,424
Non-Interest Expense:			
Salaries and associate benefits	**476,389**	289,322	215,155
Marketing	**446,264**	224,819	206,620
Communications and data processing	**150,220**	98,135	76,841
Supplies and equipment	**112,101**	82,874	60,053
Occupancy	**45,337**	37,548	22,330
Other	**241,805**	151,280	132,183
Total non-interest expense	**1,472,116**	883,978	713,182
Income before income taxes	**443,921**	305,453	248,480
Income taxes	**168,690**	116,072	93,213
Net income	**$ 275,231**	$ 189,381	$ 155,267
Basic earnings per share	**$ 4.20**	$ 2.87	$ 2.34
Diluted earnings per share	**$ 3.96**	$ 2.80	$ 2.32
Dividends paid per share	**$ .32**	$ .32	$ .32

See Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Stockholders' Equity

(Dollars in Thousands, Except Per Share Data)	Common Stock Shares	Common Stock Amount	Paid-In Capital, Net	Retained Earnings	Cumulative Other Comprehensive Income	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 1995	66,174,567	$662	$469,830	$121,703	$ 6,996		$ 599,191
Comprehensive income:							
Net income				155,267			155,267
Other comprehensive income, net of income tax:							
Unrealized losses on securities, net of income tax benefit of $2,647					(4,916)		(4,916)
Foreign currency translation adjustments					(132)		(132)
Other comprehensive income					(5,048)		(5,048)
Comprehensive income							150,219
Cash dividends–$.32 per share				(20,573)			(20,573)
Issuances of common stock	139,858	1	3,108				3,109
Exercise of stock options	11,500		186				186
Common stock issuable under incentive plan			7,728				7,728
Other items, net	(664)		531				531
Balance, December 31, 1996	66,325,261	663	481,383	256,397	1,948		740,391
Comprehensive income:							
Net income				189,381			189,381
Other comprehensive income, net of income tax:							
Unrealized gains on securities, net of income taxes of $481					532		532
Foreign currency translation adjustments					59		59
Other comprehensive income					591		591
Comprehensive income							189,972
Cash dividends–$.32 per share				(20,638)			(20,638)
Purchases of treasury stock						$(52,314)	(52,314)
Issuances of common stock	101,800	1	2,755			2,201	4,957
Exercise of stock options	130,290	2	2,614			1,466	4,082
Common stock issuable under incentive plan			24,772				24,772
Other items, net	(121)		2,037				2,037
Balance, December 31, 1997	66,557,230	666	513,561	425,140	2,539	(48,647)	893,259
Comprehensive income:							
Net income				**275,231**			**275,231**
Other comprehensive income, net of income tax:							
Unrealized gains on securities, net of income taxes of $37,170					**60,648**		**60,648**
Foreign currency translation adjustments					**(2,532)**		**(2,532)**
Other comprehensive income					**58,116**		**58,116**
Comprehensive income							**333,347**
Cash dividends–$.32 per share				**(20,533)**			**(20,533)**
Purchases of treasury stock						**(91,672)**	**(91,672)**
Issuances of common stock			**35,381**			**26,745**	**62,126**
Exercise of stock options	**1,500**		**(23,683)**			**43,323**	**19,640**
Common stock issuable under incentive plan			**70,038**				**70,038**
Other items, net	**(1,938)**		**4,201**				**4,201**
Balance, December 31, 1998	**66,556,792**	**$666**	**$599,498**	**$679,838**	**$60,655**	**$(70,251)**	**$1,270,406**

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(In Thousands)	1998	1997	1996
		Year Ended December 31	
Operating Activities:			
Net income	**$ 275,231**	$ 189,381	$ 155,267
Adjustments to reconcile net income to cash			
provided by operating activities:			
Provision for loan losses	**267,028**	262,837	167,246
Depreciation and amortization, net	**108,173**	72,674	61,235
Stock compensation plans	**70,056**	24,878	7,921
(Increase) decrease in interest receivable	**(141)**	26,707	(23,017)
Increase in accounts receivable from securitizations	**(133,771)**	(86,261)	(143,141)
Increase in other assets	**(121,951)**	(49,964)	(31,379)
Increase (decrease) in interest payable	**22,667**	(11,914)	6,431
Increase in other liabilities	**293,266**	97,914	89,964
Net cash provided by operating activities	**780,558**	526,252	290,527
Investing Activities:			
Purchases of securities available for sale	**(1,251,713)**	(1,275,900)	(947,478)
Proceeds from sales of securities available for sale	**112,277**	483,592	773
Proceeds from maturities of securities available for sale	**606,532**	450,787	490,040
Proceeds from securitizations of consumer loans	**4,616,972**	2,114,695	2,695,000
Net increase in consumer loans	**(6,144,640)**	(2,875,908)	(4,264,026)
Recoveries of loans previously charged off	**67,764**	27,462	13,300
Additions of premises and equipment, net	**(153,024)**	(51,602)	(74,871)
Net cash used for investing activities	**(2,145,832)**	(1,126,874)	(2,087,262)
Financing Activities:			
Net increase in interest-bearing deposits	**686,325**	370,632	246,985
Net increase (decrease) in other borrowings	**735,288**	265,129	(278,820)
Issuances of senior and deposit notes	**1,323,700**	529,977	2,105,864
Maturities of senior and deposit notes	**(1,218,162)**	(891,436)	(603,500)
Issuance of preferred beneficial interests		97,428	
Dividends paid	**(20,533)**	(20,638)	(20,573)
Purchases of treasury stock	**(91,672)**	(52,314)	
Net proceeds from issuances of common stock	**12,143**	6,509	3,109
Proceeds from exercise of stock options	**629**	4,082	186
Net cash provided by financing activities	**1,427,718**	309,369	1,453,251
Increase (decrease) in cash and cash equivalents	**62,444**	(291,253)	(343,484)
Cash and cash equivalents at beginning of year	**237,723**	528,976	872,460
Cash and cash equivalents at end of year	**$ 300,167**	$ 237,723	$ 528,976

See Notes to Consolidated Financial Statements.

Note A

Significant Accounting Policies

Organization and Basis of Presentation

The Consolidated Financial Statements include the accounts of Capital One Financial Corporation (the "Corporation") and its subsidiaries. The Corporation is a holding company whose subsidiaries provide a variety of products and services to consumers. The principal subsidiaries are Capital One Bank (the "Bank"), which offers credit card products, and Capital One, F.S.B. (the "Savings Bank"), which offers consumer lending products (including credit cards) and deposit products. The Corporation and its subsidiaries are collectively referred to as the "Company."

The accompanying Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles ("GAAP") that require 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. All significant intercompany balances and transactions have been eliminated. Certain prior years' amounts have been reclassified to conform to the 1998 presentation.

The following is a summary of the significant accounting policies used in preparation of the accompanying Consolidated Financial Statements.

Cash and Cash Equivalents

Cash and cash equivalents includes cash and due from banks, federal funds sold and resale agreements and interest-bearing deposits at other banks. Cash paid for interest for the years ended December 31, 1998, 1997 and 1996, was $393,565, $346,761 and $288,568, respectively. Cash paid for income taxes for the years ended December 31, 1998, 1997 and 1996, was $202,112, $131,052 and $107,065, respectively.

Securities Available for Sale

Debt securities for which the Company does not have the positive intent and ability to hold to maturity are classified as securities available for sale. These securities are stated at fair value, with the unrealized gains and losses, net of tax, reported as a component of cumulative other comprehensive income. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization or accretion is included in other interest income.

Consumer Loans

During 1997, the Company began recognizing the estimated uncollectible portion of finance charge and fee income receivables, which decreased loans and pre-tax income by $50,200 in 1997. Previously, the accrued interest and fee portions of a charged off loan balance were deducted from current period income at the time of charge-off. In addition, during 1997, the Company modified its methodology for charging off credit card loans (net of any collateral) to 180 days past-due, from the prior practice of charging off loans during the next billing cycle after becoming 180 days past-due. As a result, 1997 pre-tax income was decreased by $23,141 for the reversal of previously accrued finance charges and fee income, and reported charge-offs were increased by $11,477. Bankrupt consumers' accounts are generally charged off within thirty days of receipt of the bankruptcy petition. Annual membership fees and direct loan origination costs are deferred and amortized over one year on a straight-line basis. Deferred fees (net of deferred costs) were $140,242 and $98,619 as of December 31, 1998 and 1997, respectively.

Allowance for Loan Losses

The allowance for loan losses is maintained at the amount estimated to be sufficient to absorb probable future losses, net of recoveries (including recovery of collateral), inherent in the existing reported portfolio. The provision for loan losses is the periodic cost of maintaining an adequate allowance. The amount of allowance necessary is determined primarily based on a migration analysis of delinquent and current accounts. In evaluating the sufficiency of the allowance for loan losses, management also takes into consideration the following factors: recent trends in delinquencies and charge-offs including bankrupt, deceased and recovered amounts; historical trends in loan volume; forecasting uncertainties and size of credit risks; the degree of risk inherent in the composition of the loan portfolio; economic conditions; credit evaluations and underwriting policies.

Securitizations

The Company records gains or losses on the securitization of consumer loan receivables on the date of sale based on the estimated fair value of assets sold and retained and liabilities incurred in the sale. Gains represent the present value of estimated cash flows the Company has retained over the estimated outstanding period of the receivables. This excess cash flow essentially represents an "interest only"("I/O") strip, consisting of the excess of finance charges and past-due fees over the sum of the return paid to certificateholders, estimated contractual servicing fees and credit losses. The I/O strip is carried at fair value, with changes in the fair value reported as a component of cumulative other comprehensive income. Certain estimates inherent in the determination of the fair value of the I/O strip are influenced by factors outside the Company's control, and as a result, such estimates could materially change in the near term. The gains on securitizations and other income from securitizations are included in servicing and securitizations income.

In June 1996, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities"("SFAS 125"), which was effective January 1, 1997. The Company prospectively adopted the requirements of SFAS 125 for the securitization of consumer loans. The incremental effect of applying the new requirements was to increase servicing and securitizations income in 1997 by $32,000 ($19,840, net of tax). Prior to 1997, no gains were recorded due to the relatively short average life of the consumer loans securitized. Excess servicing fee income was recorded over the life of each sale transaction.

Off-Balance Sheet Financial Instruments

The nature and composition of the Company's assets and liabilities and off-balance sheet items expose the Company to interest rate risk. The Company's foreign currency denominated assets and liabilities expose it to foreign currency exchange rate risk. To mitigate these risks, the Company uses certain types of derivative financial instruments. The Company enters into interest rate swap agreements ("interest rate swaps") in the management of its interest rate exposure. All of the Company's interest rate swaps are designated and effective as hedges of specific existing or anticipated assets, liabilities or off-balance sheet items. The Company enters into forward foreign currency exchange contracts ("f/x contracts") and currency swaps to reduce its sensitivity to changing foreign currency exchange rates. All of the Company's f/x contracts and currency swaps are designated and effective as hedges of specific assets or liabilities. The Company does not hold or issue derivative financial instruments for trading purposes.

Swap agreements involve the periodic exchange of payments over the life of the agreements. Amounts paid or received on interest rate and currency swaps are recorded on an accrual basis as an adjustment to the related income or expense of the item to which the agreements are designated. As of December 31, 1998, the related amount payable to counterparties was $2,463. As of December 31, 1997, the related amount receivable from counterparties was $2,771. Changes in the fair value of interest rate swaps are not reflected in the accompanying financial statements, where designated to existing or anticipated assets, liabilities or off-balance sheet items and where swaps effectively modify or reduce interest rate sensitivity.

F/x contracts represent an agreement to exchange a specified notional amount of two different currencies at a specified exchange rate on a specified future date. Changes in the fair value of f/x contracts and currency swaps are recorded in the period in which they occur as foreign currency gains or losses in other non-interest income, effectively offsetting the related gains or losses on the items to which they are designated.

Realized and unrealized gains or losses at the time of maturity, termination, sale or repayment of a derivative contract are recorded in a manner consistent with its original designation. Amounts are deferred and amortized as an adjustment to the related income or expense over the original period of exposure, provided the designated asset, liability or off-balance sheet item continues to exist, or in the case of anticipated transactions, is probable of occurring. Realized and unrealized changes in the fair value of swaps or f/x contracts, designated with items that no longer exist or are no longer probable of occurring, are recorded as a component of the gain or loss arising from the disposition of the designated item.

Interest rate and foreign currency exchange rate risk management contracts are generally expressed in notional principal or contract amounts that are much larger than the amounts potentially at risk for nonperformance by counterparties. In the event of nonperformance by the counterparties, the Company's credit exposure on derivative financial instruments is limited to the value of the contracts that have become favorable to the Company. The Company actively monitors the credit ratings of its counterparties. Under the terms of certain swaps, each party may be required to pledge collateral if the market value of the swaps exceeds an amount set forth in the agreement or in the event of a change in its credit rating.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization expense are computed generally by the straight-line method over the estimated useful lives of the assets. Useful lives for premises and equipment are as follows: buildings and improvements—5-39 years; furniture and equipment—3-10 years; computers and software—3 years.

Marketing

The Company expenses marketing costs as incurred.

Credit Card Fraud Losses

The Company experiences fraud losses from the unauthorized use of credit cards. Transactions suspected of being fraudulent are charged to non-interest expense after a sixty-day investigation period.

Income Taxes

Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Comprehensive Income

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income" ("SFAS 130"). SFAS 130 established new rules for the reporting and display of comprehensive income and its components. In 1998, the Company adopted the requirements of SFAS 130, which require unrealized gains or losses on securities available for sale and foreign currency translation adjustments to be included in other comprehensive income. Prior to the adoption of SFAS 130, such amounts were reported separately in stockholders' equity. The adoption of SFAS 130 had no impact on the Company's net income or total stockholders' equity. As of December 31, 1998, 1997 and 1996, cumulative other comprehensive income net of tax consisted of $63,260, $2,612 and $2,080 in unrealized gains on securities available for sale and $(2,605), $(73) and $(132) in foreign currency translation adjustments, respectively. The provisions of SFAS 130 were applied retroactively.

Earnings per Share

Earnings per share are calculated in accordance with SFAS No. 128, "Earnings per Share" ("SFAS 128"). Pursuant to SFAS 128, basic earnings per share is based only on the weighted average number of common shares outstanding, excluding any dilutive effects of options and restricted stock. Diluted earnings per share is based on the weighted average number of common and common equivalent shares, dilutive stock options or other dilutive securities outstanding during the year.

Segments

The Company maintains three distinct business segments: lending, telecommunications and "other." The lending segment is comprised primarily of credit card lending activities. The telecommunications segment consists primarily of direct marketing cellular service. "Other" consists of various, non-lending new business initiatives.

Management measures the performance of its business segments on a managed basis and makes resource allocation decisions based upon several factors, including managed revenue generated by the segment, net of direct costs before marketing expenses. Lending is the Company's only reportable business segment, based on the definitions provided in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." Substantially all of the Company's reported assets, revenues and income are derived from the lending segment in all periods presented.

All lending revenue is generated from external customers and is predominantly derived in the United States. Lending revenues from international operations comprised less than 6% of total managed lending revenues for the year ended December 31, 1998.

Note B

Securities Available for Sale

Securities available for sale as of December 31, 1998, 1997 and 1996 were as follows:

	Maturity Schedule					
	1 Year or Less	1–5 Years	5–10 Years	Over 10 Years	Market Value Totals	Amortized Cost Totals
December 31, 1998						
Commercial paper	**$ 117,395**				**$ 117,395**	**$ 117,395**
U.S. Treasury and other U.S. government agency obligations	**125,831**	**$1,072,109**	**$17,051**		**1,214,991**	**1,196,313**
Collateralized mortgage obligations			**25,877**	**$401,443**	**427,320**	**426,485**
Mortgage backed securities		**8,337**		**7,265**	**15,602**	**15,210**
Other	**76**	**1,360**	**589**	**19,454**	**21,479**	**21,356**
Total	**$ 243,302**	**$1,081,806**	**$43,517**	**$428,162**	**$ 1,796,787**	**$ 1,776,759**
December 31, 1997						
Commercial paper	$187,145				$ 187,145	$ 187,145
U.S. Treasury and other U.S. government agency obligations	400,929	$ 589,899	$ 2,506		993,334	989,707
Collateralized mortgage obligations				$ 18,969	18,969	18,629
Mortgage backed securities		13,278		9,960	23,238	22,966
Other		330	526	19,128	19,984	20,008
Total	$588,074	$ 603,507	$ 3,032	$ 48,057	$1,242,670	$1,238,455
December 31, 1996						
Commercial paper	$ 84,297				$ 84,297	$ 84,297
U.S. Treasury and other U.S. government agency obligations	393,583	$ 354,680			748,263	745,174
Collateralized mortgage obligations				$ 20,834	20,834	20,479
Mortgage backed securities				11,607	11,607	11,849
Other				12,850	12,850	12,850
Total	$477,880	$ 354,680		$ 45,291	$ 877,851	$ 874,649

	Weighted Average Yields			
	1 Year or Less	1–5 Years	5–10 Years	Over 10 Years
December 31, 1998				
Commercial paper	**6.52%**			
U.S. Treasury and other U.S. government agency obligations	**5.87**	**5.63%**	**5.20%**	
Collateralized mortgage obligations			**5.68**	**5.78%**
Mortgage backed securities		**7.27**		**6.33**
Other	**5.83**	**3.81**	**6.43**	**6.26**
Total	**6.19%**	**5.64%**	**5.50%**	**5.81%**

Note C

Allowance for Loan Losses

The following is a summary of changes in the allowance for loan losses:

	Year Ended December 31		
	1998	1997	1996
Balance at beginning of year	**$ 183,000**	$ 118,500	$ 72,000
Provision for loan losses	**267,028**	262,837	167,246
Acquisitions/other	**7,503**	(2,770)	(18,887)
Charge-offs	**(294,295)**	(223,029)	(115,159)
Recoveries	**67,764**	27,462	13,300
Net charge-offs	**(226,531)**	(195,567)	(101,859)
Balance at end of year	**$ 231,000**	$ 183,000	$ 118,500

Note D

Premises and Equipment

Premises and equipment as of December 31, 1998 and 1997 were as follows:

	1998	1997
Land	**$ 10,168**	$ 7,849
Buildings and improvements	**126,205**	90,960
Furniture and equipment	**254,070**	182,142
Computer software	**41,084**	28,693
In process	**23,325**	2,297
	454,852	311,941
Less: Accumulated depreciation and amortization	**(212,705)**	(149,215)
Total premises and equipment, net	**$ 242,147**	$ 162,726

Depreciation expense was $75,005, $63,537 and $39,284, for the years ended December 31, 1998, 1997 and 1996, respectively.

Note E

Borrowings

Borrowings as of December 31, 1998 and 1997 were as follows:

	1998		1997	
	Outstanding	**Year-End Interest Rate**	Outstanding	Year-End Interest Rate
Interest-bearing Deposits	**$1,999,979**	**4.77%**	$1,313,654	4.49%
Other Borrowings				
Federal funds purchased and resale agreements	**$1,227,000**	**5.53%**	$ 705,863	5.75%
Other	**417,279**	**6.58**	90,249	7.09
Total	**$1,644,279**		$ 796,112	
Senior Notes				
Bank–fixed rate	**$3,268,182**	**6.29%**	$2,793,778	7.03%
Bank–variable rate	**146,998**	**5.89**	414,000	6.19
Corporation	**324,213**	**7.17**	125,000	7.25
Total	**$3,739,393**		$3,332,778	
Deposit Notes				
Fixed rate			$ 224,996	6.71%
Variable rate			75,000	6.15
Total			$ 299,996	

As of December 31, 1998, the aggregate amount of interest-bearing deposits with accounts exceeding $100 was $451,076. In September 1997, the Savings Bank completed the purchase of the national retail deposit franchise of JCPenney National Bank. Retail deposit balances acquired under the agreement were approximately $421,000.

In November 1996, the Company entered into a four-year, $1,700,000 unsecured revolving credit arrangement (the “Credit Facility”). The Credit Facility is comprised of two tranches: a $1,375,000 Tranche A facility available to the Bank and the Savings Bank, including an option for up to $225,000 in multi-currency availability, and a $325,000 Tranche B facility available to the Corporation, the Bank and the Savings Bank, including an option for up to $100,000 in multi-currency availability. The borrowings of the Savings Bank are limited to $750,000. All borrowings under the Credit Facility are based on varying terms of the London InterBank Offered Rate (“LIBOR”). The Bank has irrevocably undertaken to honor any demand by the lenders to repay any borrowings which are due and payable by the Savings Bank but which have not been paid. The facility is structured as a four-year commitment and is available for general corporate purposes. The commitment terminates on November 24, 2000; however, it may be extended for an additional one-year period. As of December 31, 1998 and 1997, the Company had no outstandings under the Credit Facility.

In August 1997, the Company entered into a three-year, $350,000 equivalent unsecured revolving credit arrangement (the "UK/Canada Facility") to finance the Company's expansion in the United Kingdom and Canada. The UK/Canada Facility is comprised of two tranches: a Tranche A facility in the amount of £156,458 ($249,800 equivalent based on the exchange rate at closing) and a Tranche B facility in the amount of C$139,609 ($100,200 equivalent based on the exchange rate at closing). An amount of £34,574 or C$76,910 ($55,200 equivalent based on the exchange rates at closing) may be transferred between the Tranche A facility and the Tranche B facility, respectively, upon the request of the Company. All borrowings under the UK/Canada Facility are based on varying terms of LIBOR. The Corporation serves as the guarantor of all borrowings under the UK/Canada Facility. The facility is structured as a three-year commitment and will be available for general corporate purposes. The commitment terminates on August 29, 2000; however, it may be extended for two additional one-year periods. As of December 31, 1998, the Company had a total of $166,345 outstanding under the UK/Canada Facility. There were no outstandings under the UK/Canada Facility as of December 31, 1997.

In April 1997, the Bank increased the aggregate amount of bank notes available under its bank note program. Under the program, the Bank from time to time may issue up to $8,000,000 of senior bank notes at fixed rates or variable rates tied to LIBOR with maturities from thirty days to thirty years. The bank note program also permits the issuance of up to $200,000 of subordinated bank notes (none issued as of December 31, 1998 and 1997) with maturities from five to thirty years.

In October 1997, the Bank established a program for the issuance of debt instruments to be offered outside of the United States. Under this program, the Bank from time to time may issue instruments in the aggregate principal amount of $1,000,000 equivalent outstanding at any one time ($5,000 and none outstanding as of December 31, 1998 and 1997, respectively). Instruments under this program may be denominated in any currency or currencies.

The Corporation has two shelf registration statements under which the Corporation from time to time may offer and sell (i) senior or subordinated debt securities, consisting of debentures, notes and/or other unsecured evidences, (ii) preferred stock, which may be issued in the form of depository shares evidenced by depository receipts and (iii) common stock. The amount of securities registered is limited to a $625,000 aggregate public offering price or its equivalent (based on the applicable exchange rate at the time of sale) in one or more foreign currencies, currency units or composite currencies as shall be designated by the Corporation. The Corporation issued $200,000 of ten-year fixed rate senior notes in July 1998 and $125,000 of seven-year fixed rate senior notes in December 1996. The remaining amount of securities available for issuance under the Corporation's shelf registrations is $300,000.

In April 1996, the Bank established a deposit note program under which the Bank from time to time may issue up to $2,000,000 of deposit notes with maturities from thirty days to thirty years.

In January 1997, Capital One Capital I, a subsidiary of the Bank created as a Delaware statutory business trust, issued $100,000 aggregate amount of Floating Rate Junior Subordinated Capital Income Securities that mature on February 1, 2027. The securities represent a preferred beneficial interest in the assets of the trust. The net proceeds of the offering of $97,428 were lent to the Bank for general corporate purposes. As of December 31, 1998, the interest rate on these securities was 6.77%.

Interest-bearing deposits and senior notes as of December 31, 1998, mature as follows (all other borrowings mature in 1999):

	Interest-Bearing Deposits	Senior Notes	Total
1999	$1,262,224	$ 799,371	$2,061,595
2000	264,687	780,082	1,044,769
2001	208,628	898,924	1,107,552
2002	36,652	111,682	148,334
2003	227,788	469,854	697,642
Thereafter		679,480	679,480
Total	$1,999,979	$3,739,393	$5,739,372

Note F

Associate Benefit and Stock Plans

The Company sponsors a contributory Associate Savings Plan in which substantially all full-time and certain part-time associates are eligible to participate. The Company matches a portion of associate contributions and makes discretionary contributions based upon the Company meeting a certain earnings per share target. The Company's contributions to this plan were $16,357, $10,264 and $9,048 for the years ended December 31, 1998, 1997 and 1996, respectively.

The Company has three stock-based compensation plans. The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related Interpretations in accounting for its stock-based compensation plans. In accordance with APB 25, no compensation cost has been recognized for the Company's fixed stock options, since the exercise price equals the market price of the underlying stock on the measurement date of grant, nor for the Associate Stock Purchase Plan (the "Purchase Plan"), which is considered to be noncompensatory.

For the performance-based option plans discussed below, compensation cost is measured as the difference between the exercise price and the target stock price required for vesting and is recognized over the estimated vesting period.

SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") requires, for companies electing to continue to follow the recognition provisions of APB 25, pro forma information regarding net income and earnings per share, as if the recognition provisions of SFAS 123 were adopted for stock options granted subsequent to December 31, 1994. For purposes of pro forma disclosure, the fair value of the options was estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions and is amortized to expense over the options' vesting period.

	Year Ended December 31		
Assumptions	**1998**	1997	1996
Dividend yield	**.32%**	.82%	.90%
Volatility factors of expected market price of stock	**40%**	40%	32%
Risk-free interest rate	**5.44%**	6.27%	5.90%
Expected option lives (in years)	**5.2**	4.5	6.0
Pro Forma Information			
Net income	**$287,637**	$186,003	$151,853
Basic earnings per share	**$ 4.39**	$ 2.82	$ 2.29
Diluted earnings per share	**$ 4.13**	$ 2.74	$ 2.27

Under the 1994 Stock Incentive Plan, the Company has reserved 10,620,880 common shares as of December 31, 1998, for issuance in the form of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock and incentive stock. The exercise price of each stock option issued to date equals the market price of the Company's stock on the date of grant. Each option's maximum term is ten years. The number of shares available for future grants was 726,223; 97,814 and 1,508,352 as of December 31, 1998, 1997 and 1996, respectively. Other than the performance-based options discussed below, options generally vest annually over three to five years and expire beginning November 2004. All options vest immediately upon a change in control of the Company.

In June 1998, the Company's Board of Directors approved a grant to senior management ("EntrepreneurGrant III"). Included in this grant as of December 31, 1998, were 870,632 performance-based options granted to certain key managers (including 666,680 options to the Company's Chief Executive Officer ("CEO") and Chief Operating Officer ("COO")) at the then market price of $101.31 per share. The Company's CEO and COO gave up 100,000 and 66,670 vested options (valued at $8,760 in total), respectively, in exchange for their EntrepreneurGrant III options. Other members of senior management gave up future cash compensation for each of the next three years in exchange for the options. All options made under this grant will vest if the Company's stock reaches $175 per share for at least ten trading days in a thirty consecutive calendar day period by June 11, 2001, or immediately upon a change in control of the Company.

In April 1998, upon stockholder approval, a 1997 stock option grant to senior management became effective at the December 18, 1997, market price of $48.75 per share. This grant included 1,143,221 performance-based options granted to certain key managers (including 685,755 options to the Company's CEO and COO), which vested in April 1998 when the market price of the Company's stock remained at or above $84.00 for at least ten trading days in a thirty consecutive calendar day period. The grant also included 223,900 options which vest in full, regardless of the stock price, on December 18, 2000, or immediately upon a change in control of the Company.

In April 1998, the Company granted 445,084 options to all associates not granted options in the above mentioned grants. Certain associates were granted options in exchange for giving up future compensation. Other associates were granted a set number of options. These options were granted at the then market price of $95.13 per share and vest, in full, on April 30, 2001, or immediately upon a change in control of the Company.

In April 1996, upon stockholder approval, a 1995 stock option grant to the Company's CEO and its COO became effective. This grant was for performance-based options to purchase 2,500,000 common shares at the September 15, 1995, market price of $29.19 per share. Vesting of the options was dependent on the fair market value of the common stock remaining at or above specified levels for at least ten trading days in any thirty consecutive calendar day period. Fifty percent of the options vested in January 1997 when the Company's stock reached $37.50 per share; 25% vested in October 1997 when the stock reached $43.75 per share; and the remaining 25% vested in January 1998 when the stock reached $50.00 per share.

The Company recognized $70,038, $24,772 and $7,728 of compensation cost relating to its associate stock plans for the years ended December 31, 1998, 1997 and 1996, respectively.

The Company maintains a non-associate directors stock incentive plan. This plan authorizes a maximum of 500,000 shares of the Company's common stock for the automatic grant of restricted stock and stock options to eligible members of the Company's Board of Directors. As of December 31, 1998, 1997 and 1996, 347,500; 382,500 and 417,500 shares were available for grant under this plan, respectively. The options vest after one year and their maximum term is ten years. The exercise price of each option equals the market price of the Company's stock on the date of grant. As of December 31, 1998, there was no outstanding restricted stock under this plan.

A summary of the status of the Company's options as of December 31, 1998, 1997 and 1996, and changes for the years then ended is presented below:

	1998		1997		1996	
	Options (000s)	Weighted Average Exercise Price Per Share	Options (000s)	Weighted Average Exercise Price Per Share	Options (000s)	Weighted Average Exercise Price Per Share
Outstanding at beginning of year	**7,125**	**$27.67**	5,894	$23.92	3,315	$19.67
Granted	**3,450**	**83.90**	1,590	40.88	2,694	29.04
Exercised	**(742)**	**20.27**	(215)	20.76	(12)	16.40
Canceled	**(120)**	**51.96**	(144)	30.16	(103)	21.82
Outstanding at end of year	**9,713**	**$47.96**	7,125	$27.67	5,894	$23.92
Exercisable at end of year	**5,966**	**$30.47**	3,815	$24.43	1,196	$18.98
Weighted average fair value of options granted during the year		**$35.45**		$16.03		$11.22

The following table summarizes information about options outstanding as of December 31, 1998:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding (000s)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price Per Share	Number Exercisable (000s)	Weighted Average Exercise Price Per Share
$16.00–$24.99	1,688	5.93 years	$ 16.43	1,358	$16.53
$25.00–$33.99	3,179	6.73	29.10	3,133	29.12
$34.00–$49.99	2,639	8.72	44.46	1,465	46.04
$50.00–$123.99	2,207	9.60	103.43	10	65.95

Under the Company's Purchase Plan, associates of the Company are eligible to purchase common stock through monthly salary deductions of a maximum of 15% and a minimum of 1% of monthly base pay. The amounts deducted are applied to the purchase of unissued common or treasury stock of the Company at 85% of the current market price. An aggregate of 1,000,000 common shares has been authorized for issuance under the Purchase Plan, of which 586,556 shares were available for issuance as of December 31, 1998.

On November 16, 1995, the Board of Directors of the Company declared a dividend distribution of one Right for each outstanding share of common stock. Each Right entitles a registered holder to purchase from the Company one one-hundredth of a share of the Company's authorized Cumulative Participating Junior Preferred Stock (the "Junior Preferred Shares") at a price of $150, subject to adjustment. The Company has reserved 1,000,000 shares of its authorized preferred stock for the Junior Preferred Shares. Because of the nature of the Junior Preferred Shares' dividend and liquidation rights, the value of the one one-hundredth interest in a Junior Preferred Share purchasable upon exercise of each Right should approximate the value of one share of common stock. Initially, the Rights are not exercisable and trade automatically with the common stock. However, the Rights generally become exercisable and separate certificates representing the Rights will be distributed, if any person or group acquires 15% or more of the Company's outstanding common stock or a tender offer or exchange offer is announced for the Company's common stock. Upon such event, provisions would also be made so that each holder of a Right, other than the acquiring person or group, may exercise the Right and buy common stock with a market value of twice the $150 exercise price. The Rights expire on November 29, 2005, unless earlier redeemed by the Company at $0.01 per Right prior to the time any person or group acquires 15% of the outstanding common stock. Until the Rights become exercisable, the Rights have no dilutive effect on earnings per share.

In July 1997, the Company's Board of Directors voted to repurchase up to two million shares of the Company's common stock to mitigate the dilutive impact of shares issuable under its benefit plans, including its Purchase Plan, dividend reinvestment plan and stock incentive plans. In July 1998, the Company's Board of Directors voted to increase this amount by an additional 1.5 million shares of the Company's common stock. For the years ended December 31, 1998 and 1997, the Company repurchased 895,800 and 1,318,641 shares, respectively, under this program. Certain treasury shares were reissued in connection with the Company's benefit plans.

Note G

Other Non-Interest Expense

	Year Ended December 31		
	1998	1997	1996
Professional services	**$ 66,591**	$ 47,671	$ 43,968
Collections	**59,503**	23,216	9,783
Bankcard association assessments	**23,163**	16,074	15,045
Fraud losses	**10,278**	16,749	26,773
Other	**82,270**	47,570	36,614
Total	**$241,805**	$151,280	$132,183

Note H

Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities as of December 31, 1998 and 1997, were as follows:

	1998	1997
Deferred tax assets:		
Allowance for loan losses	**$ 75,738**	$ 60,900
Finance charge and fee income receivables	**45,605**	17,570
Stock incentive plans	**35,949**	11,466
State taxes, net of federal benefit	**7,310**	2,694
Other	**37,078**	16,890
Subtotal	**201,680**	109,520
Valuation allowance	**(14,168)**	
Total deferred tax assets	**187,512**	109,520
Deferred tax liabilities:		
Securitizations	**29,728**	26,822
Tax-deferred revenue	**10,255**	10,167
Other	**7,814**	9,133
Total deferred tax liabilities	**47,797**	46,122
Net deferred tax assets before unrealized gains on securities available for sale	**139,715**	63,398
Unrealized gains on securities available for sale	**(38,772)**	(1,602)
Net deferred tax assets	**$100,943**	$ 61,796

During 1998, the Company established a valuation allowance related to certain federal, state and international loss carryforwards acquired or generated during the year. The net operating losses expire between 2002 and 2018.

Significant components of the provision for income taxes attributable to continuing operations were as follows:

	Year Ended December 31		
	1998	1997	1996
Federal taxes	**$244,536**	$138,877	$119,027
State taxes	**471**	393	1,715
Deferred income taxes	**(76,317)**	(23,198)	(27,529)
Income taxes	**$168,690**	$116,072	$ 93,213

The reconciliation of income tax attributable to continuing operations computed at the U.S. federal statutory tax rate to income tax expense was:

	Year Ended December 31		
	1998	1997	1996
Income tax at statutory federal tax rate	**35.00%**	35.00%	35.00%
Other, primarily state taxes	**3.00**	3.00	2.50
Income taxes	**38.00%**	38.00%	37.50%

Note I

Earnings Per Share

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

(Shares in Thousands)	Year Ended December 31 1998	1997	1996
Numerator:			
Net income	**$275,231**	$189,381	$155,267
Denominator:			
Denominator for basic earnings per share— Weighted average shares	**65,590**	66,070	66,228
Effect of dilutive securities:			
Stock options	**3,996**	1,578	790
Restricted stock	**2**	3	8
Dilutive potential common shares	**3,998**	1,581	798
Denominator for diluted earnings per share— Adjusted weighted average shares	**69,588**	67,651	67,026
Basic earnings per share	**$ 4.20**	$ 2.87	$ 2.34
Diluted earnings per share	**$ 3.96**	$ 2.80	$ 2.32

Options to purchase 2,145,281; 949,484 and 20,725 shares of common stock during 1998, 1997 and 1996, respectively, were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares and, therefore, their inclusion would be antidilutive.

Note J

Purchase of Summit Acceptance Corporation

On July 31, 1998, the Company acquired Summit Acceptance Corporation ("Summit"), based in Dallas, Texas. Summit is an indirect automobile finance lender with approximately 180 employees and managed loans of approximately $263,000 as of the purchase date. The acquisition price of $53,585 was paid through the issuance of approximately 476,000 shares of the Company's common stock from treasury. The acquisition has been accounted for as a purchase business combination. The purchase price has been allocated based on estimated fair values at the date of acquisition, resulting in goodwill of approximately $68,000 to be amortized on a straight-line basis over fifteen years. The results of Summit have been included in the Consolidated Financial Statements since the date of acquisition.

Note K

Regulatory Matters

The Bank and the Savings Bank are subject to capital adequacy guidelines adopted by the Federal Reserve Board (the "Federal Reserve") and the Office of Thrift Supervision (the "OTS") (collectively, the "regulators"), respectively. The capital adequacy guidelines and the regulatory framework for prompt corrective action require the Bank and the Savings Bank to maintain specific capital levels based upon quantitative measures of their assets, liabilities and off-balance sheet items. The inability to meet and maintain minimum capital adequacy levels could result in the regulators taking actions that could have a material effect on the Company's consolidated financial statements. Additionally, the regulators have broad discretion in applying higher capital requirements. Regulators consider a range of factors in determining capital adequacy, such as an institution's size, quality and stability of earnings, interest rate risk exposure, risk diversification, management expertise, asset quality, liquidity and internal controls.

The most recent notifications received from the regulators categorized the Bank and the Savings Bank as "well-capitalized." To be categorized as "well-capitalized," the Bank and the Savings Bank must maintain minimum capital ratios as set forth in the table below. As of December 31, 1998, there were no conditions or events since the notifications discussed above that management believes would have changed either the Bank or the Savings Bank's capital category.

	Ratios	Minimum for Capital Adequacy Purposes	To Be "Well-Capitalized" Under Prompt Corrective Action Provisions
December 31, 1998			
Capital One Bank			
Tier 1 Capital	**11.38%**	**4.00%**	**6.00%**
Total Capital	**13.88**	**8.00**	**10.00**
Tier 1 Leverage	**10.24**	**4.00**	**5.00**
Capital One, F.S.B.[1]			
Tangible Capital	**9.46%**	**1.50%**	**6.00%**
Total Capital	**13.87**	**12.00**	**10.00**
Core Capital	**9.46**	**8.00**	**5.00**
December 31, 1997			
Capital One Bank			
Tier 1 Capital	10.49%	4.00%	6.00%
Total Capital	13.26	8.00	10.00
Tier 1 Leverage	10.75	4.00	5.00
Capital One, F.S.B.[1]			
Tangible Capital	11.26%	1.50%	6.00%
Total Capital	17.91	12.00	10.00
Core Capital	11.26	8.00	5.00

(1) Until June 30, 1999, the Savings Bank is subject to capital requirements that exceed minimum capital adequacy requirements, including the requirement to maintain a minimum Core Capital ratio of 8% and a Total Capital ratio of 12%.

During 1996, the Bank received regulatory approval and established a branch office in the United Kingdom. In connection with such approval, the Company committed to the Federal Reserve that, for so long as the Bank maintains a branch in the United Kingdom, the Company will maintain a minimum Tier 1 Leverage ratio of 3.0%. As of December 31, 1998 and 1997, the Company's Tier 1 Leverage ratio was 13.49% and 13.83%, respectively.

Additionally, certain regulatory restrictions exist which limit the ability of the Bank and the Savings Bank to transfer funds to the Corporation. As of December 31, 1998, retained earnings of the Bank and the Savings Bank of $117,191 and $16,189, respectively, were available for payment of dividends to the Corporation without prior approval by the regulators. The Savings Bank, however, is required to give the OTS at least thirty days advance notice of any proposed dividend and the OTS, in its discretion, may object to such dividend.

Note L

Commitments and Contingencies

As of December 31, 1998, the Company had outstanding lines of credit of approximately $49,200,000 committed to its customers. Of that total commitment, approximately $31,800,000 was unused. While this amount represented the total available lines of credit to customers, the Company has not experienced, and does not anticipate, that all of its customers will exercise their entire available line at any given point in time. The Company generally has the right to increase, reduce, cancel, alter or amend the terms of these available lines of credit at any time.

Certain premises and equipment are leased under agreements that expire at various dates through 2008, without taking into consideration available renewal options. Many of these leases provide for payment by the lessee of property taxes, insurance premiums, cost of maintenance and other costs. In some cases, rentals are subject to increase in relation to a cost of living index. Total rental expense amounted to $18,242, $13,644 and $12,603 for the years ended December 31, 1998, 1997 and 1996, respectively.

Future minimum rental commitments as of December 31, 1998, for all non-cancelable operating leases with initial or remaining terms of one year or more are as follows:

1999	$ 19,097
2000	17,943
2001	16,687
2002	15,884
2003	14,934
Thereafter	24,980
Total	$109,525

In connection with the transfer of substantially all of Signet Bank's credit card business to the Bank in November 1994, the Company and the Bank agreed to indemnify Signet Bank (which was acquired by First Union on November 30, 1997) for

certain liabilities incurred in litigation arising from that business, which may include liabilities, if any, incurred in the purported class action case described below.

During 1995, the Company and the Bank became involved in a purported class action suit relating to certain collection practices engaged in by Signet Bank and, subsequently, by the Bank. The complaint in this case alleges that Signet Bank and/or the Bank violated a variety of California state statutes and constitutional and common law duties by filing collection lawsuits, obtaining judgements and pursuing garnishment proceedings in the Virginia state courts against defaulted credit card customers who were not residents of Virginia. This case was filed in the Superior Court of California in the County of Alameda, Southern Division, on behalf of a class of California residents. The complaint in this case seeks unspecified statutory damages, compensatory damages, punitive damages, restitution, attorneys' fees and costs, a permanent injunction and other equitable relief.

In early 1997, the California court entered judgement in favor of the Bank on all of the plaintiffs' claims. The plaintiffs appealed the ruling to the California Court of Appeals First Appellate District Division 4. In early 1999, the Court of Appeals affirmed the trial court's ruling in favor of the Bank on six counts, but reversed the trial court's ruling on two counts of the plaintiffs' complaint. The Bank intends to petition for further appellate review of the ruling on the two remaining counts.

Because no specific measure of damages is demanded in the complaint of the California case and the trial court entered judgement in favor of the Bank before the parties completed any significant discovery, an informed assessment of the ultimate outcome of this case cannot be made at this time. Management believes, however, that there are meritorious defenses to this lawsuit and intends to defend it vigorously.

The Company is commonly subject to various other pending and threatened legal actions arising from the conduct of its normal business activities. In the opinion of management, the ultimate aggregate liability, if any, arising out of any pending or threatened action will not have a material adverse effect on the consolidated financial condition of the Company. At the present time, however, management is not in a position to determine whether the resolution of pending or threatened litigation will have a material effect on the Company's results of operations in any future reporting period.

Note M
Related Party Transactions

In the ordinary course of business, executive officers and directors of the Company may have consumer loans issued by the Company. Pursuant to the Company's policy, such loans are issued on the same terms as those prevailing at the time for comparable loans to unrelated persons and do not involve more than the normal risk of collectibility.

Note N
Securitizations

The Company securitized $4,616,972 ($245,752 international), $2,114,695 and $2,695,000 of consumer loan receivables for the years ended December 31, 1998, 1997 and 1996, respectively. As of December 31, 1998, receivables under securitizations outstanding consisted of $1,309,518 of retained ("seller's") interests and $11,742,081 of investors' undivided interests, maturing from 1999 to 2008.

The terms of securitizations require the Company to maintain a certain level of assets, retained by the trust, to absorb potential credit losses. The amount available to absorb potential credit losses was included in accounts receivable from securitizations and was $263,426 and $231,809 as of December 31, 1998 and 1997, respectively.

Note O
Off-Balance Sheet Financial Instruments

The Company has entered into interest rate swaps to effectively convert certain interest rates on bank notes from variable to fixed. The pay-fixed, receive-variable swaps, which had a notional amount totaling $157,000 as of December 31, 1998, will mature from 2001 to 2007 to coincide with maturities of the variable bank notes to which they are designated. The Company has also entered into amortizing notional interest rate swaps to effectively convert certain interest rates on fixed rate consumer loans from fixed to variable, thereby reducing the interest rate sensitivity of loan securitizations. These pay-fixed, receive-variable interest rate swaps, which had an amortizing notional amount totaling $2,877,000 as of December 31, 1998, will amortize through 2004 and 2005 to coincide with the estimated attrition of the fixed rate consumer loans to which they are designated. The Company also had a pay-fixed, receive-variable interest rate swap with an amortizing notional amount of C$225,000, which will amortize through 2003 to coincide with the estimated attrition of the fixed rate Canadian dollar consumer loans to which it is designated.

The Company has also entered into currency swaps that effectively convert fixed rate pound sterling interest receipts to fixed rate U.S. dollar interest receipts on pound sterling denominated assets. These currency swaps had notional amounts totaling $260,000 as of December 31, 1998, and mature from 2001 to 2005, coinciding with the repayment of the assets to which they are designated.

The Company has entered into f/x contracts to reduce the Company's sensitivity to foreign currency exchange rate changes on its foreign currency denominated assets and liabilities. As of December 31, 1998, the Company had f/x contracts with notional amounts totaling $1,005,000, which mature in 1999 to coincide with the repayment of the assets to which they are designated.

In 1997, the Company entered into swaps to effectively offset certain pay-variable, receive-fixed swaps which were designated to fixed rate bank notes and securitization liabilities. The offsetting swaps had maturities and terms which paid-fixed and received-

variable rates to match the original swaps. As of December 31, 1998 and 1997, the original swaps had notional amounts totaling $291,000 and $1,041,000, respectively. The offsetting swaps also had notional amounts totaling $291,000 and $1,041,000 as of December 31, 1998 and 1997, respectively. As of December 31, 1998, the variable rate payments on the original and offsetting swaps were matched and will continue to offset each other through the swaps' maturities in 1999 and 2000.

Note P

Significant Concentration of Credit Risk

The Company is active in originating consumer loans, primarily in the United States. The Company reviews each potential customer's credit application and evaluates the applicant's financial history and ability and willingness to repay. Loans are made primarily on an unsecured basis; however, certain loans require collateral in the form of cash deposits. International consumer loans are originated primarily in Canada and the United Kingdom. The geographic distribution of the Company's consumer loans was as follows:

	Year Ended December 31			
	1998		1997	
Geographic Region	**Loans**	**Percentage of Total**	Loans	Percentage of Total
South	**$ 5,868,386**	**33.74%**	$ 5,061,414	35.57%
West	**3,609,952**	**20.75**	3,361,556	23.62
Northeast	**3,032,061**	**17.43**	2,835,256	19.92
Midwest	**2,992,334**	**17.20**	2,533,469	17.80
International	**1,892,393**	**10.88**	439,320	3.09
	17,395,126	**100.00%**	14,231,015	100.00%
Less securitized balances	**(11,238,015)**		(9,369,328)	
Total	**$ 6,157,111**		$ 4,861,687	

Note Q

Disclosures About Fair Value of Financial Instruments

The following discloses the fair value of financial instruments as of December 31, 1998 and 1997, whether or not recognized in the balance sheets. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument. As required under GAAP, these disclosures exclude certain financial instruments and all non-financial instruments. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

The following methods and assumptions were used by the Company in estimating the fair value of its financial instruments as of December 31, 1998 and 1997:

Cash and Cash Equivalents

The carrying amounts of cash and due from banks, federal funds sold and resale agreements and interest-bearing deposits at other banks approximated fair value.

Securities Available for Sale

The fair value of securities available for sale was determined using current market prices. See Note B.

Consumer Loans

The net carrying amount of consumer loans, including the Company's seller's interest in securitized consumer loan receivables, approximated fair value due to the relatively short average life and variable interest rates on a substantial number of these loans. This amount excluded any value related to account relationships.

Interest Receivable

The carrying amount approximated fair value.

Interest Only Strips

The fair value of the I/O strips was determined using discounted cash flow calculations. Cash flows are estimated based on the latest forecast for the activity related to securitized loans.

Borrowings

The carrying amounts of interest-bearing deposits, other borrowings and deposit notes approximated fair value. The fair value of senior notes was $3,769,000 and $3,351,000 as of December 31, 1998 and 1997, respectively, and determined based on quoted market prices.

Interest Payable

The carrying amount approximated fair value.

Off-Balance Sheet Financial Instruments

The fair value was the estimated net amount that the Company would have (paid)/received to terminate the interest rate swaps, currency swaps and f/x contracts at the respective dates, taking into account the forward yield curve on the swaps and the forward rates on the currency swaps and f/x contracts. As of December 31, 1998 and 1997, the estimated fair value was $(64,713) and $5,800, respectively.

Note R

Recent Accounting Pronouncements

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), which is required to be adopted in years beginning after June 15, 1999. SFAS 133 permits early adoption as of the beginning of any fiscal quarter after its issuance. SFAS 133 will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change

in fair value will be immediately recognized in earnings. The Company has not yet determined what the effect of SFAS 133 will be on the earnings and financial position of the Company.

In March 1998, the American Institute of Certified Public Accountants issued Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1"), which is required to be adopted in years beginning after December 15, 1998. The Company plans to adopt SOP 98-1 on January 1, 1999. SOP 98-1 will require the capitalization of certain costs incurred after the date of adoption in connection with developing or obtaining software for internal use. The Company currently expenses such costs as incurred. As a result of adopting the new SOP, the Company expects to capitalize certain internal use software costs in 1999 that otherwise would have been expensed as incurred; however, the effect on 1999 net income is not expected to be material. The expected impact of the adoption of SOP 98-1 is based on estimates of future activity, which could change materially in the near term.

Note S

Capital One Financial Corporation (Parent Company Only) Condensed Financial Information

	December 31	
Balance Sheets	**1998**	1997
Assets:		
Cash and cash equivalents	**$ 10,887**	$ 203
Investment in subsidiaries	**1,211,255**	818,518
Loans to subsidiaries(1)	**375,396**	207,507
Other	**62,316**	5,001
Total assets	**$1,659,854**	$1,031,229
Liabilities:		
Senior notes	**$ 324,213**	$ 125,000
Borrowings from subsidiaries	**54,200**	3,300
Other	**11,035**	9,670
Total liabilities	**389,448**	137,970
Stockholders' equity	**1,270,406**	893,259
Total liabilities and stockholders' equity	**$1,659,854**	$1,031,229

(1) As of December 31, 1998 and 1997, includes $108,400 and $143,500, respectively, of cash invested at the Bank instead of the open market.

	Year Ended December 31		
Statements of Income	**1998**	1997	1996
Interest from temporary investments	**$ 12,485**	$ 11,352	$ 2,296
Interest expense	**18,212**	11,067	3,013
Dividends, principally from bank subsidiaries	**260,000**	228,000	117,400
Non-interest income	**893**	56	
Non-interest expense	**2,700**	409	571
Income before income taxes and equity in undistributed earnings of subsidiaries	**252,466**	227,932	116,112
Income tax benefit	**2,863**	25	490
Equity in undistributed earnings of subsidiaries	**19,902**	(38,576)	38,665
Net income	**$275,231**	$189,381	$155,267

	Year Ended December 31		
Statements of Cash Flows	**1998**	1997	1996
Operating Activities:			
Net income	**$ 275,231**	$ 189,381	$ 155,267
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed earnings of subsidiaries	**(19,902)**	38,576	(38,665)
(Increase) decrease in other assets	**(56,682)**	(2,183)	2,079
Increase in other liabilities	**1,365**	3,290	6,380
Net cash provided by operating activities	**200,012**	229,064	125,061
Investing Activities:			
Increase in investment in subsidiaries	**(172,119)**	(83,366)	(119,502)
Increase in loans to subsidiaries	**(167,889)**	(102,507)	(105,000)
Net cash used for investing activities	**(340,008)**	(185,873)	(224,502)
Financing Activities:			
Increase in borrowings from subsidiaries	**50,900**	3,300	
Issuance of senior notes	**199,213**		125,000
Dividends paid	**(20,533)**	(20,638)	(20,573)
Purchases of treasury stock	**(91,672)**	(52,314)	
Net proceeds from issuances of common stock	**12,143**	6,509	3,109
Proceeds from exercise of stock options	**629**	4,082	186
Net cash provided by (used for) financing activities	**150,680**	(59,061)	107,722
Increase (decrease) in cash and cash equivalents	**10,684**	(15,870)	8,281
Cash and cash equivalents at beginning of year	**203**	16,073	7,792
Cash and cash equivalents at end of year	**$ 10,887**	$ 203	$ 16,073

Directors and Officers

Capital One Financial Corporation
Board of Directors

Richard D. Fairbank
Chairman and Chief Executive Officer
Capital One Financial Corporation

Nigel W. Morris
President and Chief Operating Officer
Capital One Financial Corporation

W. Ronald Dietz*
Managing Partner
Customer Contact Solutions, LLC

James A. Flick, Jr.*
President and Chief Executive Officer
Dome Corporation

Patrick W. Gross*
Founder and Chairman, Executive Committee
American Management Systems, Inc.

James V. Kimsey**
Founding CEO and Chairman Emeritus
America Online, Inc.

Stanley I. Westreich**
President
Westfield Realty, Inc.

* Audit Committee
** Compensation Committee

Capital One Financial Corporation
Executive Officers

Richard D. Fairbank
Chairman and Chief Executive Officer

Nigel W. Morris
President and Chief Operating Officer

Marjorie M. Connelly
Sr. Vice President, Credit Card Operations

Matthew J. Cooper
Sr. Vice President

James P. Donehey
Sr. Vice President and Chief Information Officer

John G. Finneran, Jr.
Sr. Vice President, General Counsel and Corporate Secretary

Dennis H. Liberson
Sr. Vice President, Human Resources

William J. McDonald
Sr. Vice President, Brand Management

Peter A. Schnall
Sr. Vice President, Marketing and Analysis

David M. Willey
Sr. Vice President, Finance and Accounting

Corporate Information

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Annual Meeting
Thursday, April 29, 1999, 10:00 a.m. Eastern Time
Fairview Park Marriott Hotel
3111 Fairview Park Drive
Falls Church, VA 22042

Principal Financial Contact
Paul Paquin
Vice President, Investor Relations
Capital One Financial Corporation
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Copies of Form 10-K filed with the Securities and Exchange Commission are available without charge, upon written request to Paul Paquin at the above address.

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Stock Symbol COF
Member of S&P 500

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