



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

December 21, 2007

Andres L. Navarette, Esq.
Managing Vice President and
Chief Counsel – Regulatory
Capital One Financial Corporation
1680 Capital One Drive
McLean, Virginia 22102

Dear Mr. Navarette:

This is in response to the request by Capital One Financial Corporation (“Capital One”), on behalf of Capital One, National Association (“CONA”), both in McLean, Virginia, for an exemption from section 23A of the Federal Reserve Act and the Board’s Regulation W to permit CONA to acquire all the shares of its affiliate, Capital One Auto Finance, Inc. (“Auto Finance”), Plano, Texas.¹ The proposed transaction is the final step in a reorganization by Capital One designed to streamline its corporate structure by consolidating its primary consumer and commercial banking operations into CONA.

Section 23A and Regulation W limit the amount of “covered transactions” between a bank and any single affiliate to 10 percent of the bank’s capital stock and surplus and limit the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank’s capital stock and surplus. “Covered transactions” include a bank’s purchase of assets from an affiliate and a bank’s extension of credit to an affiliate. The statute and regulation also require a bank to secure its extensions of credit to, and certain other covered transactions with, affiliates with prescribed amounts of collateral. In addition, section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate.

Regulation W provides that a bank’s acquisition of a security issued by a company that was an affiliate of the bank before the acquisition is treated as a

¹ 12 U.S.C. § 371c; 12 CFR part 223.

purchase of assets by the bank from an affiliate if (i) the company becomes an operating subsidiary of the bank as a result of the transaction and (ii) the company has liabilities at the time of the acquisition.² Auto Finance is currently an affiliate of CONA and would become an operating subsidiary of CONA immediately after the reorganization. At the time of the restructuring, Auto Finance would have outstanding liabilities. Accordingly, Capital One's transfer of all the capital stock of Auto Finance to CONA would be an asset purchase subject to the quantitative and qualitative limitations of section 23A and Regulation W. The Regulation W value of the covered transaction would be approximately [REDACTED] – the total liabilities of Auto Finance at the time of the reorganization.³

To accomplish the reorganization, Capital One has requested an exemption from section 23A and Regulation W to permit CONA to acquire all the shares of Auto Finance. Section 23A and Regulation W specifically authorize the Board to exempt, in its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds such exemptions to be in the public interest and consistent with the purposes of section 23A.⁴

The Board has approved exemptions under section 23A for one-time asset transfers that are part of a corporate reorganization and that are structured to ensure the quality of the transferred assets. As in previous cases reviewed by the Board, the proposed transaction in this case is a byproduct of a one-time corporate reorganization. Capital One is consolidating its automobile lending into CONA as part of a larger reorganization. According to Capital One, this exemption is in the public interest because the reorganization is expected to enhance the efficiency of its lending programs, to streamline its management, and to reduce its operating expenses.

As part of this transaction, Capital One proposes to transfer approximately [REDACTED] in low-quality assets to CONA. Section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate. Under Board precedent, however, CONA would not be viewed as purchasing any low-quality assets from an affiliate as part of the proposed reorganization because

² See 12 CFR 223.31(a).

³ See 12 CFR 223.31(b).

⁴ 12 U.S.C. § 371c(f)(2); 12 CFR 223.43(a).

Capital One has committed to contribute to CONA ██████████ in cash to offset the low-quality assets.⁵

In addition, Capital One has made the following commitments as part of the exemption request:

1. Capital One commits that it will contribute funds to CONA in the amount of the book value of any low-quality assets that are transferred to CONA at the time that Auto Finance is transferred to CONA. Capital One also commits that CONA will hold an amount of risk-based capital equal to the book value of any low-quality assets that are transferred to CONA so long as CONA retains ownership or control of the transferred assets. For example, under this dollar-for-dollar capital requirement, the risk-based capital charge for each transferred low-quality loan asset would be 100 percent (equivalent to a 1250 percent risk weight), rather than the 8 percent requirement (equivalent to a 100 percent risk weight) that would apply to a similar defaulted loan asset that is not a part of the transferred asset pool.
2. Capital One commits for a four-year period following the contribution of Auto Finance to make either (i) a cash payment to CONA equal to the book value at the end of each calendar quarter plus write-downs during that quarter by CONA of any transferred assets (other than those that were low-quality assets at the time of the initial transfer) that were low-quality assets at the end of that quarter; or (ii) quarterly purchases from CONA of any transferred assets (other than those that were low-quality assets at the time of the initial transfer) that were low-quality assets at the end of that quarter at a price equal to the book value at the end of that quarter plus write-downs during that quarter by CONA of any such transferred assets. Capital One will make the cash payment or will purchase the assets within 30 days after the end of each calendar quarter. Capital One also commits that CONA will hold an amount of risk-based capital equal to the book value of any transferred assets that become low-quality so long as CONA retains ownership or control of the transferred assets as

⁵ See Board letters dated June 30, 2006, to Carl Howard, Esq. (Citigroup); December 22, 2004, to Winthrop N. Brown, Esq. (HSBC Bank); and February 27, 2003, and August 28, 2001, to Carl Howard, Esq. (Citigroup).

described in the example above.

3. Capital One commits for a four-year period following the contribution of Auto Finance to make cash contributions to CONA equal to (i) any amount that CONA is required to contribute to any securitization vehicle that is transferred to CONA at the time that Auto Finance is transferred to CONA to support the performance of that vehicle trust and (ii) the amount of any write-down during each calendar quarter of any transferred residual or retained interest in the vehicle. Capital One will make the cash contribution within 30 days after the end of each calendar quarter. Capital One also commits that CONA will hold additional capital equal to such amounts so long as CONA retains ownership or control of the exposures.
4. Before the purchase of assets is consummated, a majority of CONA's directors will review and approve the transaction.

As a condition of this exemption CONA must remain well capitalized based on the Office of the Comptroller of the Currency's risk-based capital guidelines and the modifications to those guidelines described in commitments (1) through (3) above. These commitments are similar to commitments relied on by the Board in previous cases.⁶ These commitments have been modified, however, to clarify that the funds transferred by Capital One to CONA to support any low-quality assets will provide a cushion of additional capital in excess of CONA's required regulatory capital. The commitments ensure that these funds will remain available to the bank and may not be returned to Capital One through a dividend or a return of capital.

Both Capital One and CONA are well capitalized and well managed and would remain so after the transaction. In addition, the Office of Comptroller of the Currency and the Federal Deposit Insurance Corporation have reviewed the transaction and informed the Board that they have no objection to the proposal.

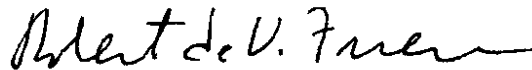
In light of these considerations and all the facts you have presented, the reorganization transaction appears to be consistent with safe and sound banking practices and on terms that would ensure the quality of the assets transferred. Accordingly, the transaction appears to be consistent with the purposes of

⁶ See 12 CFR 223.41(d).

section 23A, and the Director of the Division of Banking Supervision and Regulation, pursuant to authority delegated by the Board, and with the concurrence of the General Counsel, hereby grants the requested exemption.

This determination is specifically conditioned on compliance by Capital One, CONA, and Auto Finance with all the commitments and representations made in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing in connection with granting the request and, as such, may be enforced in proceedings under applicable law. This determination is based on the specific facts and circumstances of the proposed transaction and may be revoked if there is a material change in those facts and circumstances or failure by Capital One, CONA, or Auto Finance to observe its commitments or representations. Granting this exemption does not represent a determination concerning the permissibility of any other transactions engaged in by Capital One, CONA, or Auto Finance that are subject to section 23A or Regulation W.

Sincerely yours,



Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Richmond
Federal Deposit Insurance Corporation
Office of Comptroller of the Currency
