

CAPITAL BANK plc

REPORT AND ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2005

Company Number 392902



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Directors' Report

The Directors have pleasure in presenting their Report and Accounts for the year ended 31 December 2005 for CAPITAL BANK plc ('the Company').

Principal Activities

The principal activities of the Company are the provision of finance and related financial services to customers, including leasing and instalment credit, acting as a holding Company for the Capital Bank group (CAPITAL BANK plc and subsidiaries 'the group'), investing in various subsidiaries and jointly controlled entities and providing loan funding to those entities. A list of the main subsidiary undertakings and the nature of their business is given in Note 11 to the Accounts on page 22.

Results and Dividends

The profit before tax for the year ended 31 December 2005 amounted to £269 million (year ended 31 December 2004 - £123 million). During 2005 a final ordinary dividend of £120 million was paid in respect of 2004 and an interim ordinary dividend of £150 million was paid in respect of the year ended 31 December 2005.

Payment Policy

The Company's suppliers are paid through HBOS plc's centralised Accounts Payable department.

The Group's policy for the payment of suppliers is as follows:-

Payment terms are agreed at the start of the relationship with the supplier and are only changed by agreement.

Standard payment terms to suppliers of goods and services is 30 days from receipt of a correct invoice for satisfactory goods or services which have been ordered and received, unless other terms are agreed in a contract;

Payment is made in accordance with the agreed terms or in accordance with the law if no agreement has been made; and

Suppliers are advised without delay when an invoice is contested and disputes are settled as quickly as possible.

The average number of days credit taken at 31 December 2005 by HBOS plc was 13 days.

Directors

The current Directors are:

J. Coyle

P.J. Cummings

D.R. Fryatt

J. Morris

L. Town

A. Webster

Mr P. J. Cummings was appointed as a Director on 11 November 2005. Mr A. Christie resigned as a Director on 5 January 2005, Mr J. Maclean resigned as a Director on 27 April 2005, Mr M. Wooderson resigned as a Director on 14 November 2005 and Mr G. E. Mitchell resigned as a Director on 14 November 2005. Mr L. Town was appointed a Director on 12 January 2006.

Directors' Report (Continued)

Directors' Share Interests

Shares

The beneficial interests of the Directors and their immediate families in the ordinary shares of HBOS plc are set out below:

Table 1

	Number of shares at 31.12.05	Number of shares at 31.12.04 or date of appointment if later
J. Coyle	49,938	31,581
P. J. Cummings	71,097	71,097
D. R. Fryatt	70,515	54,602
J. Morris	28,622	41,834
A. Webster	100,075	155,078

Short-term Incentive Plans – HBOS Scheme

Certain Directors have conditional entitlements to shares arising from the annual incentive sharekicker. Where the annual incentive for any year was taken in shares ('basic shares') and these shares are retained in trust for three years, the following additional shares may also be transferred to the Directors.

Table 2

	Grant effective from	Shares
		31.12.05
J. Coyle	Mar 2003	2,845
	Mar 2004	2,034
	Mar 2005	3,140
P.J. Cummings	Mar 2003	998
	Mar 2004	1,903
	Mar 2005	5,404
D.R. Fryatt	Mar 2003	2,135
	Mar 2004	2,275
	Mar 2005	2,953
J. Morris	Mar 2003	4,849
	Mar 2004	4,360
	Mar 2005	4,807
A. Webster	Mar 2003	3,720
	Mar 2004	2,525
	Mar 2005	5,673

Notes to Table 2

Note 1: Shares under these plans were granted using the market price at the date of grant, as follows:

Plan	Share Grant Price
	£
Mar 2003 – Mar 2006	6.76
Mar 2004 – Mar 2007	7.36
Mar 2005 – Mar 2008	8.19

Directors' Report (Continued)

Note 2:

Shares will be released after three years, subject to the basic shares still being held and subject to the participant still being in the Group's employment at that time or being a qualifying leaver.

Long-term Incentive Plan– HBOS Scheme

Details of the shares which have been conditionally awarded to Directors under the plans are set out below. The performance conditions relating to these conditional awards are set out in the notes below the table.

Table 3

	Grant effective from	At 31.12.04	Granted (G) or Lapsed (L) in year	Added as a result of performance	Dividend reinvestment shares	Redeemed in year	At 31.12.05
J. Coyle	Jan 2002	10,416		10,416	3,138	(23,970)	0
	Jan 2003	13,541					13,541
	Jan 2004	13,482					13,482
	Jan 2005		11,904(G)				11,904
P.J.Cummings	Jan 2002	13,333		13,333	4,018	(30,684)	0
	Jan 2003	18,750					18,750
	Jan 2004	27,894					27,894
	Jan 2005		23,809(G)				23,809
D. R. Fryatt	Jan 2002	6,013		6,013	1,812	(13,838)	0
	Jan 2003	7,708					7,708
	Jan 2004	15,806					15,806
	Jan 2005		13,492(G)				13,492
J. Morris	Jan 2002	15,000		15,000	4,520	(34,520)	0
	Jan 2003	19,375					19,375
	Jan 2004	21,385					21,385
	Jan 2005		19,444(G)				19,444
A. Webster	Jan 2002	12,500		12,500	3,766	(28,766)	0
	Jan 2003	17,708					17,708
	Jan 2004	18,596					18,596
	Jan 2005		15,873(G)				15,873

Shares granted under these plans can crystallise at any level between 0% and 200% of the conditional award noted in the above table, dependent upon performance. The performance period for the January 2002 grant ended on 31 December 2004 and in the light of the performance outcome, grants were released at 200% of the conditional award. On maturity, dividend reinvestment shares equivalent to approximately 30% of the original conditional grant were also released to participants in accordance with the rules of the plan.

Directors' Report (Continued)

Long-term Incentive Plans – HBOS Scheme, former Bank of Scotland and former Halifax Scheme

Share options granted between 1995 and 2000 under the Bank of Scotland Executive Stock Option Scheme 1995 are subject to performance pre-conditions, which have now been satisfied. Share options granted under other plans are not subject to a performance precondition. Details of the options outstanding under these plans are set out below.

Table 4

	Options outstanding at 31.12.04 or date of appointment if later	Granted	Lapsed	Exercised	At 31.12.05
D.R. Fryatt	27,367				27,367
A Webster	26,000				26,000

Sharesave Plan

Share options granted under these plans are set out below.

Table 2

	At 31.12.04 or date of appointment if later	Granted	Lapsed	Exercised	At 31.12.05
					31.12.05
J. Coyle	4,177	838		(994)	4,021
D.R. Fryatt	3,036	627		(795)	2,868
J Morris	1,607				1,607
A Webster	4,840	260		(823)	4,277
P.J. Cummings					

Directors' Report (Continued)

Corporate Governance and Directors' Remuneration

The Company follows the principles of good governance set out in the Combined Code. No separate report on corporate governance or Directors' remuneration is presented here as full details are contained in the Report and Accounts of HBOS plc, the Group's ultimate parent undertaking.

Going Concern

The Directors are satisfied that the company has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts.

Auditors

A resolution to re-appoint KPMG Audit Plc as auditors will be put to the members at the forthcoming Annual General Meeting.

On behalf of the Board



P. Gittins

Company Secretary

20 February 2006

Statement of Directors' Responsibilities in Respect of the Report and Accounts of CAPITAL BANK plc and the Financial Statements

The Directors are responsible for preparing the report and accounts of CAPITAL BANK plc and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU.

The financial statements are required by law to present fairly the financial position and performance of the Company; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing these financial statements, the directors are required to:

select suitable accounting policies and then apply them consistently;

make judgements and estimates that are reasonable and prudent;

state whether they have been prepared in accordance with IFRS as adopted by the EU; and

prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Independent Auditors' Report to the Shareholders of CAPITAL BANK plc

We have audited the Company financial statements (the 'financial statements') of CAPITAL BANK plc for the year ended 31 December 2005 which comprise the Income Statement, Balance Sheet, Statement of Recognised Income and Expense, Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Report and Accounts, and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 6.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Report and Accounts and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

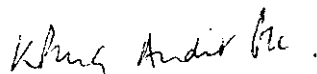
Opinion

In our opinion:

The financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the Company's affairs as at 31 December 2005 and of its profit for the year then ended.

The financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

KPMG Audit Plc



Chartered Accountants

Registered Auditor

Edinburgh

20 February 2006

Accounting Policies

Statement of compliance

The 2005 statutory financial statements set out on pages 11 to 42 have been prepared in accordance with International Financial Reporting Standards ('IFRS').

The Standards adopted by the Company are those endorsed by the European Union and effective at the date the IFRS financial statements were approved by the Board.

These are the Company's first financial statements prepared in accordance with IFRS. An explanation of how the transition has affected the reported financial position of the Company is provided in Notes 35 and 36.

The accounts also comply with the relevant provisions of Part VII of the Companies Act 1985, as amended by the Companies Act 1985 (International Accounting Standards and Other Accounting Amendments) Regulations 2004.

Basis of preparation

The financial statements have been prepared under the historical cost basis, except that the following assets and liabilities are stated at their fair values; derivative financial instruments, financial instruments held for trading, financial instruments designated at fair value through the income statement, financial instruments classified as available-for-sale and investment properties.

Exemptions on first-time adoption of IFRS

The Company has adopted the following exemptions set out in IFRS 1, 'First-time Adoption of International Financial Reporting Standards'.

2004 comparative information

Using the exemptions within IFRS 1, IAS 32 and IAS 39 only became effective from 1 January 2005. Where the implementation of these standards resulted in a change in accounting policy from 1 January 2005, the 2004 comparatives do not reflect the provisions of these standards. The policy applied in respect of such 2004 comparative information has been set out at the end of this section (under the heading '2004 Accounting Policies' Page 10). The related 2005 policy has been annotated with an asterisk in the heading to indicate the change in policy. Where there is no asterisk, the 2005 policy has been applied consistently to both periods presented in the accounts.

Subsidiaries

Subsidiaries and special purpose entities are entities controlled by the Company. Control is defined as where the Company has power, directly or indirectly, to govern the financial and operating policies of such entities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. In accordance with the exemption afforded by s228 of the Companies Act 1985, consolidated accounts have not been prepared.

Jointly controlled entities

Jointly controlled entities are entities over which the Company has joint control under a contractual arrangement with other parties.

Derivatives*

Derivatives are initially recognised at fair value on the date the contract is entered into and are subsequently remeasured at their fair value. Where the fair value of a derivative is positive, it is carried as a derivative asset and where negative, as a derivative liability. The gain or loss on remeasurement to fair value at the balance sheet date is taken to the income statement. The only circumstance where this will not apply is when cash flow hedge accounting is employed.

Hedge accounting allows one financial instrument, generally a derivative such as a swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of the same. At inception of the hedge relationship formal documentation must be drawn up specifying the hedging strategy, the component

transactions and the methodology that will be used to measure effectiveness.

Monitoring of hedge effectiveness is undertaken on an ongoing basis. A hedge is regarded as effective if the change in fair value or cash flows of the hedge and the hedged item are correlated within a range of 80% to 125% either for the period since effectiveness was last tested or cumulatively since inception.

The Company uses three hedge accounting methods.

Firstly, fair value hedging measures the change in the fair value of the derivative against the offsetting changes in the fair value of the hedged item in respect of the risk being hedged. These changes in fair value are recognised through the income statement. If this hedge is highly effective then the net impact on the income statement is minimised.

Secondly, cash flow hedging matches the cash flows of hedged items against the corresponding cashflow of the hedging derivative. The effective part of any gain or loss on the derivative is recognised directly in equity and the hedged item is accounted for in accordance with the policy for that financial instrument.

In circumstances where the hedge relationship proves ineffective or is early settled or terminated then the associated gains and losses that were recognised directly in reserves are reclassified in the income statement in the same period or periods during which the asset acquired or liability assumed affects profit or loss. The ineffective part of any gain or loss is recognised immediately in the income statement.

Thirdly, hedging of net investment in foreign operations is discussed within the foreign currencies accounting policy.

Adjustments made to the carrying amount of the hedged item for fair value hedges will be amortised on an effective interest rate basis. In respect of cash flow hedges, the amount deferred in reserves will either remain in equity until the designated transaction occurs or, if not expected to occur, be recognised in the income statement.

A derivative may be embedded in another financial instrument, known as the host contract. Where the economic characteristics and risks of an embedded derivative are not closely related to those of the host contract the embedded derivative is separated from the host and held on balance sheet at fair value. Movements in fair value are posted to the income statement, whilst the host contract is accounted for according to the policy for that class of financial instrument.

Loans and advances*

Loans and advances are held at amortised cost less provision for impairment.

The Company will assess impairment individually for financial assets that are significant and individually or collectively for assets that are not significant.

Individual impairment is identified at a counterparty specific level following objective evidence that a financial asset is impaired. This may be after an interest or principal payment is missed or when a banking covenant is breached. The present value of estimated cash flows recoverable is determined after taking into account any security held. The amount of any impairment is calculated by comparing the present value of the cash flows discounted at the loan's original effective interest rate with the balance sheet carrying value. If impaired, the carrying value is adjusted and the difference charged to the income statement.

The written down value of the impaired loan is compounded back to the net realisable balance over time using the original effective interest rate. This is reported through interest receivable within the income statement and represents the unwinding of the discount.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established provisions for impairment or directly to the income statement.

In circumstances where an asset has been individually assessed for impairment and no objective evidence of impairment exists, then it will be subject to a collective assessment.

Collective impairment is identified for groups of assets that share similar risk characteristics.

Collective impairment is assessed using a methodology based on existing risk conditions or events that have a strong correlation with a tendency to default.

Loans and advances to customers include advances that are subject to non-returnable finance arrangements following securitisation of portfolios of mortgages and other advances. The principal benefits of these advances were acquired by special purpose securitisation companies that fund their purchase primarily through the issue of floating rate notes. These floating rate notes are accounted for through 'Debt securities in issue' on the face of the balance sheet.

Finance leases, instalment credit and operating leases

Assets leased to customers that transfer substantially all of the risks and rewards incidental to ownership to the customer are classified as finance leases. Together with instalment credit agreements, they are recorded at an amount equal to the net investment in the lease, less any provisions for impairment, within loans and advances to customers.

The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return.

All other assets leased to customers are classified as operating leases. These assets are separately disclosed in the balance sheet and are recorded at cost less aggregate depreciation, which is calculated on a straight-line basis. Operating lease rentals are recognised in operating income on a straight-line basis over the lease term. Operating lease assets are reviewed for impairment when there is an indication of impairment.

Intangible assets

Goodwill

The excess of the cost of a business combination over the interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the date of acquisition, of subsidiary undertakings, associated undertakings (including jointly controlled entities) and other businesses, is capitalised as goodwill.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill carried in the balance sheet is subject to a bi-annual impairment review by comparing the value in use with the carrying value. When this indicates that the carrying value is not recoverable, it is written down through the income statement by the amount of any impaired loss identified.

Software development costs

Costs associated with the development of software for internal use, subject to de minimis limits, are capitalised if the software is technically feasible and the Company has both the intent and sufficient resources to complete the development. Costs are only capitalised if the asset can be reliably measured, will generate future economic benefits and there is an ability to use or sell the asset.

Only costs that are directly attributable to bringing the asset into working condition for its intended use are capitalised. These costs include all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in a manner intended by management. Other development expenditure, including software research development costs, are recognised in the income statement as an expense as incurred.

Capitalised development expenditure and purchased software is stated at cost less accumulated amortisation and impairment losses. Once the software is ready for use, the capitalised costs are amortised over their expected lives, generally four years. Capitalised software

is assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The depreciation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

Subsequent expenditure is only capitalised when it increases the future economic benefits embodied in the specific asset to which it relates.

Property and equipment

Property and Equipment is stated at cost less accumulated depreciation and impairment losses.

Freehold land is not depreciated. Freehold and leasehold property, other than freehold investment properties, is stated at cost and depreciated over 50 years or the length of the lease term if shorter. Improvements to leasehold properties with unexpired lease terms of 50 years or less are stated at cost and are depreciated in equal instalments over the lesser of the remaining life of the lease or eight years. Premiums are amortised over the period of the lease.

The cost of equipment, which includes fixtures and fittings, vehicles and computer hardware, less estimated residual value, is written off in equal instalments over the expected lives of the assets, generally between three and fifteen years.

Subsequent costs are included in the asset's carrying amount, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably.

Property and equipment is assessed for impairment where there is an indication of impairment. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The depreciation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

Taxation

Income tax on the profit and loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. The tax charge is analysed between tax that is payable in respect of policyholders' returns and tax that is payable on equity holder returns. This allocation is based on an assessment of the effective rate of tax that is applicable to equity holders for the year.

Deferred tax is provided using the Balance Sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided: goodwill not deductible for tax purposes, the initial recognition of assets and liabilities that affects neither accounting or taxable profit and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates at the balance sheet date.

Other borrowed funds*

Other borrowed funds comprises preference shares that are classified as debt and subordinated liabilities, all of which are held at amortised cost.

Preference shares are classified as debt where they are redeemable on a specific date or at the option of the shareholders or if dividend payments are not discretionary. Dividends on preference shares classified as debt are recognised in the income statement through interest payable.

Subordinated liabilities consists of dated and undated loan capital. The interest payable is recognised in the income statement through interest payable.

Collateral and netting*

Assets and liabilities are shown net where there is a legal right of offset and there is an intention and ability to settle on a net basis. The Company nets loans, deposits and derivative transactions where it enters into master agreements with counterparties where there is an intention and ability to settle net.

Foreign currencies

The financial statements are presented in Sterling which is the Company's functional and presentation currency.

Foreign currency transactions are translated into Sterling at the exchange rate prevailing at the date of the transaction.

Cash and cash equivalents

Cash and cash equivalents are held for the purpose of meeting short term cash commitments rather than investing or other purposes. Cash and cash equivalents consist of cash and balances with central banks that are freely available and non-equity investments with a maturity of three months or less from the date of acquisition.

Effective interest rate*

Revenue on financial instruments classified as loans and receivables, available for sale, or financial liabilities at amortised cost, is recognised on an effective interest rate basis. This calculation takes into account interest received or paid, fees and commissions paid or received that are integral to the yield as well as incremental transaction costs. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability at initial recognition.

2004 Accounting policies

The 2004 comparatives do not reflect the provisions of the standards in respect of IAS 32 and IAS 39. The policies applied in respect of the 2004 comparative information has been set out below. These policies are in addition to those identified on pages 8 to 10 where the 2005 policy has been applied consistently to both periods presented in the accounts.

Derivatives

Derivative financial instruments used for trading and non-trading purposes include interest rate swaps, cross currency swaps, futures, options, forward rate agreements and caps, floors and collars.

Trading derivatives, which include customer driven and proprietary transactions and hedges thereof, are carried in the accounts at fair value with gains or losses included in net trading income. The fair value is based on quoted market prices. Where representative market prices are not available, the fair value is determined from appropriate financial models using the actual or modelled cash flows. Fair value adjustments are made, where appropriate, to cover credit risk, liquidity risk and future administrative costs.

Non-trading derivatives, which are used primarily as a risk management tool for hedging interest rate and foreign exchange rate risk arising on on-balance sheet assets and liabilities, are accounted for on the same basis as the underlying items being hedged.

In order to qualify as a hedge, a derivative must effectively reduce any risk inherent in the hedged item from potential movements in interest rates, exchange rates and market values. Changes in the fair value of the derivative must be highly correlated with changes in the fair value of the underlying hedged item over the life of the hedged contract. Gains and losses on instruments used for hedging purposes are not recognised until the exposure that is being hedged is itself recognised. Where a hedge transaction is terminated early, any profit or loss is spread over the remainder of the original life of the hedge contract. In other circumstances, where the underlying item subject to the hedge is extinguished, the hedge transaction is measured at fair value and any profit or loss is recognised immediately.

Loans and advances

Loans and advances are held at cost less provisions.

Specific provisions are made for advances that are recognised to be bad or doubtful. Specific provisions are assessed on a case by case basis or, where this is not practical, as part of a portfolio or similar advances using loan loss estimation models. A general provision, to cover advances that are latently bad or doubtful, but not yet identified as such, is also maintained based on loan loss estimation models. The models reflect the historical loan loss experience relevant to the particular market segment or product and include adjustments for economic and business climate factors and management experience.

Provisions made during the year are charged to the income statement, net of recoveries. If the collection of interest is considered doubtful, it is suspended and excluded from interest income in the income statement. Provisions and suspended interest are written off to the extent that there is no longer any realistic prospect of recovery.

Debt securities

Debt securities and other fixed interest securities held for trading are included at market value with gains or losses included in dealing profits. The difference between the cost and market value of securities held for trading is not disclosed as its determination is not practicable.

Debt securities and other fixed interest securities held for the longer term are included at cost less amounts written off and adjusted for the amortisation of premiums or discounts arising on purchase of investments redeemable at fixed dates. Such premiums or discounts are taken to interest receivable on a straight line basis over the period to redemption. The use of a straight line basis does not result in a material difference to the amount of amortisation taken to interest receivable compared to the amortisation had a level gross yield basis been used. Gains or losses on realisation are recorded in other operating income as they arise.

Fees and commissions

Arrangement fees and commissions receivable for the continuing service of loans and advances are recognised on the basis of work done. Those receivables in respect of bearing risk, including premiums received by the Group on high loan to value mortgages, are recognised on a straight line basis over the expected period of the advance of risk exposure. Other fees are recognised when receivable.

Fees and commission payable to third parties are normally charged to the income statement as incurred. For certain categories of business, fees are amortised over a period not exceeding four years.

Dated and undated loan capital

Dated and undated loan capital is included at the nominal value adjusted for premiums, discounts and expenses, all of which are amortised evenly over the period to redemption or reset. This does not result in a material difference to the amount of amortisation had a level gross yield basis been used.

Interest receivable and payable

Interest receivable and payable is recognised in the income statement on an accruals basis. If the collection of interest is considered doubtful, it is suspended and excluded from interest income in the income statement.

Income Statement

For the year ended 31 December 2005

	Notes	2005 £ million	2004 £ million
Interest receivable		1,086	1,087
Interest payable		(946)	(901)
Net interest income		140	186
Dividend income from subsidiary undertakings		293	98
Fees and commission income		22	39
Fees and commission expense		(7)	(22)
Net trading expense		(1)	
Other operating income		10	6
Net operating income (all from continuing operations)	1	457	307
Administrative expenses	2	(138)	(124)
Depreciation and amortisation			
Property and equipment	13	(9)	(10)
Operating lease assets	14	(1)	(1)
Intangible assets other than goodwill	12	(1)	
Goodwill impairment	12		(6)
Operating expenses		(149)	(141)
Impairment losses on loans and advances	8	(59)	(47)
Operating profit (all from continuing operations)		249	119
Non-operating income	4	20	4
Profit before taxation		269	123
Tax on profit	6	12	(25)
Profit after taxation		281	98
Attributable to:			
Shareholders		281	98

Balance Sheet**As at 31 December 2005**

	Notes	31 December 2005 £ million	31 December 2004 £ million
Assets			
Cash and balances at central banks		26	27
Derivative assets	22	8	
Loans and advances to banks		1,018	956
Loans and advances to customers	7	18,874	19,480
Investment securities	9	7	7
Interests in jointly controlled entities	10	5	5
Interests in subsidiary undertakings	11	50	50
Goodwill and other intangible assets	12		1
Property and equipment	13	50	56
Operating lease assets	14	7	7
Current tax assets		14	
Other assets		93	90
Deferred tax assets	15	10	9
Prepayments and accrued income		17	26
Total assets		20,179	20,714
Liabilities			
Deposits by banks		18,473	19,002
Customer accounts		33	49
Derivative liabilities	22	17	
Current tax liabilities			18
Other liabilities	16	5	9
Accruals and deferred income		264	291
Other provisions		1	
Other borrowed funds	17	779	643
Total liabilities		19,572	20,012
Shareholders' equity			
Issued share capital	18	70	200
Share premium		3	3
Retained earnings		534	499
Shareholders' equity	19	607	702
Total liabilities and shareholders' equity		20,179	20,714

Approved by the Board on 20 February 2006 and signed on its behalf by:

P. J. Cummings

J. Coyle

James Coyle

Statement of Recognised Income and Expense ('SORIE')**For the year ended 31 December 2005**

	31 December 2005	31 December 2004
	£ Million	£ Million
Profit after taxation	281	98
Total recognised income and expense	281	98
Change in accounting policy:		
Retained earnings reserve	24	
Total recognised income and expenses restated	305	
Attributable to:		
Shareholders	305	98

Cash Flow Statement

For the year ended 31 December 2005

	31 December 2005	31 December 2004
	£ million	£ million
Profit before tax	269	123
Adjustments for:		
Losses on loans and advances	59	47
Depreciation and amortisation	10	17
Other non-cash items	2	3
Net change in operating assets and liabilities	167	(408)
Net cash flows from operating activities before tax	507	(218)
Income taxes paid	(11)	(1)
Cash flows from operating activities	496	(219)
Cash flows from investing activities	(3)	(2)
Cash flows from financing activities	(270)	68
Net increase in cash and cash equivalents	223	(153)
Opening cash and cash equivalents	437	590
Closing cash and cash equivalents	660	437

Analysis of cash and cash equivalents

	31 December 2005	31 December 2004
	£ million	£ million
Cash and balances at central banks		
Loans and advances to other banks – repayable in less than 3 months	660	437
Closing cash and cash equivalents	660	437

	31 December 2005	31 December 2004
	£ million	£ million
Investing activities		
Purchase of operating assets		(7)
Sale of property and equipment	(3)	(3)
Investment in subsidiary undertakings		8
Cash flows from investment activities	(3)	(2)

	31 December 2005	31 December 2004
	£ million	£ million
Financing activities		
Issue of other borrowed funds		80
Equity dividends paid	(270)	
Preference dividends paid		(12)
Cash flows from financing activities	(270)	68

Notes to the Accounts

1. Net operating income

	2005	2004
	£ million	£ million
Net operating income is after taking account of:		
Net trading expense	(1)	

2. Administrative expenses

During 2005 HBOS plc became the employer for most UK based employees in the HBOS Group. Consequently, the Company has no employees. Staff and related costs are recharged from HBOS plc.

The average number of persons recharged to the Company during the year is

	2005	2004
	Number	Number
Full time	3,109	3,433
Part time	634	625
	3,743	4,058

No Directors received emoluments for qualifying services to CAPITAL BANK plc in the year ended 31 December 2005.

	2005	2004
	£ million	£ million
Administrative costs include:		
Staff costs	80	67
Accommodation, repairs and maintenance	8	6
Technology	5	5
Marketing and communication	31	30

3. Auditors' remuneration

The aggregate remuneration of KPMG Audit Plc and its associates for audit (excluding VAT) is analysed below.

	2005	2004
	£ 000	£ 000
Audit services	48	48
Total audit services	48	48

4. Non-operating income

Non operating income comprises the profit on sale of fixed asset investments amounting to £20m (2004 £4m).

5. Post retirement benefits

The Group operates a number of employee benefit plans in its various countries of operation. The Group operates pension schemes on a defined benefit basis as well as a defined contribution pension plan. These plans have been accounted for under IAS 19 covering employee benefits. IAS 19 requires disclosure of certain information about the plans as follows:

Defined contribution post employment benefit plans

The HBOS Group ('Group') provides several defined contribution schemes, including the HBOS Group Money Purchase Scheme. This scheme is the only plan open to new employees as the defined benefit schemes are closed to new members. It is funded by contributions from employees and the Group. At the lowest contribution level employees make contributions of 2% of pensionable salaries while the Group makes contributions at 3%. Normal employee contributions are made at rates of 2% to 5% and Group contributions can range between 3% to 9%.

Notes to the Accounts (Continued)

5 Post retirement benefits (continued)**Defined benefit post employment benefit plans**

The Group provides various pension plans that operate on a defined benefit basis. The principal defined benefit pension scheme applicable to the Company, is the Bank of Scotland 1976 Pension Scheme ('The Scheme'), which is a funded scheme.

The assets of The Scheme are held in trust funds which are independent of the Group's own assets. In determining the level of contributions required to be made to The Scheme and the relevant charges to the Group's income statement, the Group has been independently advised by independent actuaries. The most recently published formal valuations of the Scheme were carried out on 31 December 2004. The financial assumptions are derived based upon the economic conditions prevailing at the date of valuation.

The amount included in the balance sheet arising from the Group's obligations in respect of its defined benefit plans is as follows:

	The Scheme 2005 £ million	The Scheme 2004 £ million
Defined Benefit obligation	(2,723)	(2,125)
Fair value of assets	1,909	1,491
Net Post Retirement Benefit Liabilities	(814)	(634)
Movements in the net post retirement benefit liability were as follows:		
As at 1 January	(634)	(530)
Pension expense	(88)	(94)
Employer contributions	159	59
Actuarial gains and losses	(251)	(69)
At 31 December	(814)	(634)
Movements in the defined benefit obligation were as follows:		
At 1 January	2,125	1,903
Current service cost	85	84
Contributions by plan participants	4	5
Interest cost	114	105
Benefits paid	(58)	(60)
Actuarial gains and losses	452	82
Past service cost	1	6
At 31 December	2,723	2,125
Movements in the fair value of plan assets were as follows:		
At 1 January	1,491	1,373
Actual return on plan assets	313	114
Employer contributions	159	59
Plan participant contributions	4	5
Benefits paid	(58)	(60)
At 31 December	1,909	1,491

Notes to the Accounts (Continued)

5 Post retirement benefits (continued)

	The Scheme 2005 £ million	The Scheme 2004 £ million
Included within the fair value of plan assets at 31 December were the following:		
Equity instruments	1,315	1,142
Bonds	199	60
Fixed interest gilts	238	234
With property investments		
Property occupied by the company	105	43
Other assets	52	12
Total value of assets	1,909	1,491
The actual rate of return is calculated as follows:		
Expected return on plan assets	112	101
Actuarial gain on plan assets	201	13
Actual return on plan assets	313	114
The history of experience adjustments is as follows:-		
Defined benefit obligation	(2,723)	(2,125)
Fair value of plan assets	1,909	1,491
Funded status	(814)	(634)
Experience adjustments on plan liabilities		
Amounts (£ million)	66	18
Percentage of scheme liabilities (%)	2	1
Experience adjustments on plan assets		
Amounts (£ million)	(201)	(13)
Percentage of plan assets (%)	11	1

	The Scheme 2005 £ million	The Scheme 2004 £ million
The expense recognised in the income statement for the year ending 31 December is comprised as follows:		
Service Cost	85	84
Interest Cost	114	105
Expected return on assets	(112)	(101)
Other/past service cost	1	6
Total pension expense	88	94

The Group's policy for recognising actuarial gains and losses is to take them directly to reserves in the period in which they are incurred. £251m was recognised in the statement of recognised income and expense in the year (2004 £69 - million). Cumulative actuarial gains and losses recognised in the statement of recognised income and expense at 31 December 2005 amount to £320m (2004 - £69 million)

*Notes to the Accounts (Continued)***6. Taxation**

	2005	2004
	£ million	£ million
Current tax- Corporation tax credit / (charge) at 30 per cent (2004 - 30 per cent)	10	(13)
Deferred taxation (note 15)	2	(12)
Total income tax on profit	12	(25)
The above tax credit/expense is made up as follows:		
Tax on shareholder return	12	(25)

The tax assessed in the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2005	2004
	£ million	£ million
Profit before taxation	269	123
Profit multiplied by the standard rate of corporation tax in the UK of 30% (2004 30%)	(81)	(37)
Effects of:		
Income / expenses not taxable / deductible for tax purposes	86	23
Book gains covered by capital losses/ indexation	6	
Amounts written off fixed asset investments	(1)	(2)
Adjustments in respect of previous periods	2	(9)
Total income tax on profit	12	(25)

Notes to the Accounts (Continued)

7. Loans and advances to customers

	2005	2004
	£ million	£ million
Gross loans and advances to customers	19,024	19,664
Impairment provisions (note 8)	(150)	(184)
Net loans and advances to customers	18,874	19,480

Included in the above are loans to:

Subsidiary undertakings £11,244 million

Jointly controlled entities £2,740 million

At 31 December 2005 loans and advances to customers designated as loans and receivables under IAS 39 are measured at amortised cost on the balance sheet. The fair value of loans and advances to customers is disclosed in Note 24.

A maturity analysis of loans and advances to customers is shown in Note 29.

The Company's lending exposure before the deduction of impairment provisions and before taking account of collateral is analysed below.

	2005	2004
	£ million	£ million
Agriculture, forestry and fishing	137	131
Manufacturing industry	223	269
Construction and property	246	288
Hotels, restaurants and wholesale and retail trade	425	611
Transport, storage and communication	302	343
Financial	14,094	14,462
Other services	612	546
Other personal lending	2,824	2,834
Overseas residents	161	180
	19,024	19,664

Notes to the Accounts (Continued)

Loans and advances to customers include finance leases of £3,617 million (2004 £3,473 million) analysed as follows:

	2005	2004
	£ million	£ million
Gross investment in finance receivables		
Within one year	1,964	1,864
Between one and five years	2,079	1,983
More than five years	92	119
	4,135	3,966
Less unearned finance income	(518)	(493)
Present value of minimum lease payments	3,617	3,473
Analysed as		
Within one year	1,720	1,634
Between one and five years	1,816	1,736
More than five years	81	103
Finance lease receivables	3,617	3,473

At 31 December 2005 total accumulated allowance for uncollectable minimum lease payments receivable amounted to £29m (2004 £9m).

8. Impairment losses on loans and advances

	2005	2004
	£ million	£ million
At 1 January 2005	167	196
New impairment provisions less releases	66	52
Amounts written off	(79)	(64)
Discount unwind on impaired:		
Loans and advances to customers	(4)	
Cumulative provisions as at 31 December 2005	150	184
New impairment provisions less releases	66	52
Recoveries of amounts previously written off	(7)	(5)
Net charge to Income Statement	59	47

9. Investment securities

	2005			2004
	Available for sale	Total	Book Value	Market Value
	£ million	£ million	£ million	£ million
Investment securities				
Unlisted debt securities	7	7	7	7
Total investment securities	7	7	7	7

Notes to the Accounts (Continued)

10. Interests in jointly controlled entities

	2005	2004
	Book	Book
	Value	Value
Interests in jointly controlled entities	£ million	£ million
At 1 January 2005 and 31 December 2005	5	5

All the interests in jointly controlled entities are unlisted.

	Nature of Business	Issued Share and Loan Capital		Group's Interest	Statutory Accounts Made up to	Principal Area of Operations
Incorporated in the UK						
Jointly controlled entities:						
AA Personal Finance Limited	Finance	ordinary	£1,500,002	50%	December 2005	UK
Britannia Personal Lending Limited	Finance	ordinary	£51,000	51%	December 2005	UK
NFU Mutual Finance Limited	Finance	ordinary	£250,002	50%	December 2005	UK
RFS Limited	Finance	ordinary	£3,000,004	50%	December 2005	UK
Corporate Aircraft Leasing Limited	Leasing	ordinary	£500,000	50%	December 2005	UK
Renault Truck Contracts Limited	Finance	ordinary	£250,000	50%	December 2005	UK
Cartwright Limited	Finance	ordinary	£25,000	50%	December 2005	UK

Notes to the Accounts (Continued)

11. Interests in subsidiary undertakings

	2005	2004
	Total	Total
	£ million	£ million
At cost at 1 January 2005 and 31 December 2005	50	50

The main subsidiary undertakings are as follows:-

	Company's Interest		
	In Ordinary		
	Share Capital and		
	Voting Rights	Principal Business	Incorporated
British Linen Asset Finance Limited	100%	Leasing	UK
British Linen Leasing Limited	100%	Leasing	UK
Bank of Scotland Equipment Finance Limited	100%	Leasing	UK
British Linen Shipping Limited	100%	Leasing	UK
Capital Bank Cashflow Finance Limited	100%	Debt Factoring	UK
Capital Bank Leasing 1 Limited	100%	Leasing	UK
Capital Bank Leasing 2 Limited	100%	Leasing	UK
Capital Bank Leasing 3 Limited	100%	Leasing	UK
Capital Bank Leasing 4 Limited	100%	Leasing	UK
Capital Bank Leasing 5 Limited	100%	Leasing	UK
Capital Bank Leasing 6 Limited	100%	Leasing	UK
Capital Bank Leasing 7 Limited	100%	Leasing	UK
Capital Bank Leasing 8 Limited	100%	Leasing	UK
Capital Bank Leasing 9 Limited	100%	Leasing	UK
Capital Bank Leasing 10 Limited	100%	Leasing	UK
Capital Bank Leasing 11 Limited	100%	Leasing	UK
Capital Bank Leasing 12 Limited	100%	Leasing	UK
Capital Bank Vehicle Management Limited	100%	Contract Management	UK
Daewoo Direct Finance Limited	100%	Finance	UK
Forthright Finance Limited	100%	Finance	UK
Godfrey Davies (Contract Hire) Limited	100%	Contract Hire	UK
Inchcape Financial Services Limited	51%	Finance	UK
International Motor Finance Limited	51%	Finance	UK
Membership Services Finance Limited	80%	Finance	UK
MVI Financial Services Limited	51%	Finance	UK
NWS Trust Limited	100%	Finance	UK
The Mortgage Business plc	100%	Mortgage Loans	UK

Notes to the Accounts (Continued)

12. Goodwill and other intangible assets

2005			
	Software £ million	Total £ million	
Cost			
At 1 January 2005	4	4	
At 31 December 2005	4	4	
Amortisation			
At 1 January 2005	3	3	
Amortisation charge in year	1	1	
At 31 December 2005	4	4	
Carrying value at 31 December 2005			
2004			
	Goodwill £ million	Software £ million	Total £ million
Cost			
At 31 December 2003	16	3	19
Change in accounting policy	(10)		(10)
At 1 January 2004	6	3	9
Impairment losses	(6)		(6)
Additions – internally developed		1	1
At 31 December 2004		4	4
Amortisation			
At 31 December 2003	10	3	13
Change in accounting policy	(10)		(10)
At 1 January 2004		3	3
At 31 December 2004		3	3
Carrying value at 31 December 2004		1	1

Notes to the Accounts (Continued)

13. Property and equipment

	Property	Equipment	Total
	£ million	£ million	£ million
2005			
Cost			
At 1 January 2005	48	102	150
Additions	3	15	18
Disposals		(43)	(43)
At 31 December 2005	51	74	125
Depreciation			
At 1 January 2005	16	78	94
Depreciation for year	2	7	9
Disposals		(28)	(28)
At 31 December 2005	18	57	75
Carrying value at 31 December 2005	33	17	50
2004			
Cost			
At 1 January 2004	50	100	150
Additions	2	12	14
Disposals	(4)	(10)	(14)
At 31 December 2004	48	102	150
Depreciation			
At 1 January 2004	15	72	87
Depreciation for year	2	8	10
Disposals	(1)	(2)	(3)
At 31 December 2004	16	78	94
Carrying value at 31 December 2004	32	24	56

Notes to the Accounts (Continued)

14. Operating lease assets

Assets leased to customers include the following amounts in respect of operating lease assets:

	Cost	Depreciation	Carrying Value
	£ million	£ million	£ million
2005			
At 1 January 2005	8	(1)	7
Additions	1		1
Depreciation charge for the year		(1)	(1)
At 31 December 2005	9	(2)	7

	Cost	Depreciation	Carrying Value
	£ million	£ million	£ million
2004			
At 1 January 2004			
Additions	8		8
Depreciation charge for the year		(1)	(1)
At 31 December 2004	8	(1)	7

Future minimum lease payments under non-cancellable leases are expected to be received in the following periods;

	2005	2004
	£ million	£ million
1 year or less	1	1
Later than 1 year and not later than five years	8	7
	9	8

Notes to the Accounts (Continued)

15. Deferred tax

	2005	2004
	£ million	£ million
Deferred tax liabilities	(11)	(14)
Deferred tax assets	21	23
Net position	10	9

	2005	2004
	£ million	£ million
At 1 January 2005	9	16
Change in accounting policy	(1)	5
Opening balance – restated	8	21
Charge to income for the year (note 6)	2	(12)
At 31 December 2005	10	9

Analysed as follows

Deferred tax liabilities	Capital Allowances	2005
	£ million	Total £ million
At 1 January 2005	(14)	(14)
Charge to income for the year	3	3
At 31 December 2005	(11)	(11)

Deferred tax assets	Provisions	Other	2005
	£ million	£ million	Total £ million
At 1 January 2005	18	5	23
Change in accounting policy	(1)		(1)
Opening balance – restated	17	5	22
Charge to income for the year	(1)		(1)
At 31 December 2005	16	5	21

16. Other liabilities

	2005	2004
	£ million	£ million
Other liabilities	5	9
	5	9

Notes to the Accounts (Continued)

17. Other borrowed funds

	2005	2004
	£ million	£ million
Preference shares	136	
Subordinated liabilities		
Dated	478	478
Undated	165	165
Total	779	643

Preference shares

	2005	2004
	£ million	£ million
9 3/8% Non-cumulative Irredeemable Preference shares	136	

Following the adoption of IAS 32 from 1 January 2005 the 9 3/8% Non-cumulative Irredeemable Preference Shares above were reclassified from shareholders equity to other borrowed funds. In line with this reclassification for the year ended at 31 December 2005 the preference dividend of £12 million has been charged to interest payable within the Income Statement. The corresponding amount for 2004 of £12 million has been charged directly to the Profit and Loss Account reserve.

Subordinated liabilities

	2005	2004
	£ million	£ million
Dated		
£66 million floating rate notes dated seven years from 31 December 2002 extended by one year upon each anniversary thereafter unless notice is given to repay	66	66
£55 million floating rate notes 2006	55	55
£30 million floating rate notes 2007	30	30
£79 million floating rate notes 2007	79	79
£60 million floating rate notes 2009	60	60
£14 million floating rate notes 2009	14	14
£14 million floating rate notes 2009	14	14
£80 million floating rate notes dated five years from the 1 January following the notice of demand for repayment	80	80
£80 million floating rate notes 2009	80	80
	478	478
Undated		
£165 million floating rate notes	165	165

No repayment, for whatever reason, of dated loan capital prior to its stated maturity and no purchase by the relevant undertaking of its subordinated debt may be made without the consent of the Financial Services Authority. On a winding up of the relevant company, the claims of the holders of dated loan capital shall be subordinated in right of payment to the claims of all depositors and creditors of that company other than creditors whose claims are expressed to rank *pari passu* with or junior to the claims of the holders of the dated loan capital.

No exercise of any redemption option or purchase by the Company of any of its undated loan capital may be made without the consent of the Financial Services Authority. On a winding up of the Company the claims of the holders of undated loan capital shall be subordinated in right of payment to the claims of all depositors and creditors of the Company undertaking other than creditors whose claims are expressed to rank *pari passu* with or junior to the claims of the holders of the undated loan capital. The undated loan capital is junior in point of subordination to the dated loan capital referred to above.

Notes to the Accounts (Continued)

18. Share capital

The authorised share capital of the Company comprises 440 million (2004 440 million) ordinary shares of 25p each.

	Ordinary Stock 25p each £ million	9 3/8 % Non- Cumulative Irredeemable Preference Stock £1 each £ million	Total £ million
Issued, allotted, called up and fully paid			
At 1 January 2004 and 31 December 2004	70	130	200
Change in accounting policy		(130)	(130)
At 1 January 2005 – restated and 31 December 2005	70		70

£130 million 9 3/8% Non-cumulative Irredeemable Preference shares of £1 each classified as share capital at 31 December 2004 were reclassified as other borrowed funds (Note 17) following the adoption of IAS 39 on 1 January 2005.

Notes to the Accounts (Continued)

19. Reconciliation of shareholders equity

2005	Issued share capital £ million	Share premium £ million	Retained earnings £ million	Total £ million
At 31 December 2004	200	3	499	702
Changes in accounting policy	(130)		24	(106)
At 1 January 2005 restated	70	3	523	596
Profit after tax			281	281
Total recognised income and expense			281	281
Dividends paid in 2005			(270)	(270)
At 31 December 2005	70	3	534	607

2004	Issued share capital £ million	Share premium £ million	Retained earnings £ million	Total £ million
At 31 December 2003	200	3	467	670
Changes in accounting policy			(54)	(54)
At 1 January 2004 restated	200	3	413	616
Profit after tax			98	98
Total recognised income and expense			98	98
Dividends paid in 2004			(12)	(12)
At 31 December 2004	200	3	499	702

20. Dividends

		2005 £ million	2004 £ million
Preference dividends	Paid		6
	Payable		6
			12
Ordinary dividend	Final 2004	120	
	Interim 2005	150	
		270	12

Notes to the Accounts (Continued)

21. Commitments and contingencies

The contract amounts noted below indicate the volume of business outstanding at the balance sheet date in respect of contingent liabilities and commitments undertaken for customers. They do not reflect the underlying credit and other risks, which are significantly lower.

	2005	2004
	Contract	Contract
	Amount	Amount
	£ million	£ million
Commitments		
Up to and including 1 year	283	342
over 1 year	84	109
	367	451

22. Derivatives

The Company uses derivative instruments to hedge and reduce the interest rate exposures that are inherent in any banking business. The hedge accounting strategy adopted by the Company is to utilise a macro cashflow hedge approach. The remaining derivatives held by the Company are held for economic hedging purposes but do not meet the criteria for hedge accounting under IAS39. As such, the gain or loss arising from the change in fair value is taken to the income statement. Where a derivative does not qualify for hedge accounting in 2005 it is classified below as held for trading.

The Company has entered into derivative contracts as noted below. Notional principal amount represents the value of the contract to which the derivative relates and are provided to assist the comparison with financial instrument values on the balance sheet.

2005	Notional Principal Amount £ million	Year End Fair Value Asset Liability £ million	
Derivatives held for hedging			
Derivatives designated as cash flow hedges:			
Forward rate agreements	315	7	7
Total derivatives held for hedging	315	7	7
Derivatives held for trading:			
Exchange and rate related contracts:			
Cross currency swaps	27	1	
	27	1	
Equity/index and commodity related contracts:			
Options and swaps	1,281		10
Total derivatives held for trading	1,308	1	10
Total derivatives held for hedging	315	7	7
Total derivatives	1,623	8	17

Notes to the Accounts (Continued)

22. Derivatives (continued)

In line with the requirements of IFRS 1 'First time adoption of International Financial Reporting Standards' the following derivative table for 2004 has been disclosed as reported under the previous GAAP.

2004	Notional	Fair Value	
	Principal	Asset	Liability
	Amount		
	£ million	£ million	£ million
Forward foreign exchange	23	6	
	23	6	

Credit risk analyses

Counterparties of the Company's derivative transactions are primarily financial institutions. An institutional and geographical analysis of replacement cost, based on the location of the office writing the business, is shown below:

	2004 £ million
Institutional	
Non-financial institutions	6
	6
Geographical	
UK	6
	6

Notes to the Accounts (Continued)

23. Hedges

In line with the requirements of IFRS 1 'First time adoption of International Financial Reporting Standards' the following hedging table for 2004 has been disclosed as reported under the previous GAAP.

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on instruments used for hedging and the movements therein, are as follows:

2004	Total Net		
	Gains	Losses	Gains / (Losses)
	£ million	£ million	£ million
Unrecognised gains and losses on hedges at 1 January 2004	17	(80)	(63)
Gains and losses arising in previous years that were recognised in the year ended 31 December 2004	(17)	80	63
Gains and losses arising before 1 January 2004 that were not recognised in the year ended 31 December 2004			

24. Fair value of financial instruments

The fair values of financial instruments are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or reprice frequently, fair value approximates to carrying value. The classification adopted by the Company is shown in the following table:

2005	At Fair Value through income statement		Loans and Receivables	
	Carrying	Fair	Carrying	Fair
	Amount	Value	Amount	Value
	£ million	£ million	£ million	£ million
Assets				
Derivative assets	8	8		
Loans and advances to banks			1,018	1,018
Loans and advances to customers			18,874	19,030
Investment securities			7	7
Other assets			134	134
Total financial assets	8	8	20,033	20,189

Notes to the Accounts (Continued)

24. Fair value of financial instruments (continued)

2005	At fair value through the		Loans and receivables	
	income statement			
	Carrying	Fair	Carrying	Fair
	Amount	Value	Amount	Value
	£ million	£ million	£ million	£ million
Liabilities				
Deposits by banks			18,473	18,473
Customer accounts			33	33
Derivative liabilities	17	17		
Other borrowed funds			779	871
Other liabilities			269	269
Total financial liabilities	17	17	19,554	19,646

Fair value of financial instruments 2004

In line with the requirements of IFRS 1 'First time adoption of International Financial Reporting Standards' the following fair value of financial assets and financial liabilities table for 2004 has been disclosed as previously reported under the previous GAAP.

For the table below the fair values of financial assets and financial liabilities are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or reprice frequently fair value approximates to carrying value.

Derivatives held for non-trading purposes are accounted for in the same way as the underlying transaction being hedged. Fair values are based on market prices where available, or are estimated using other valuation techniques.

The following table shows the carrying amount and the fair value of financial assets and liabilities:

2004	Assets		Liabilities	
	Carrying	Fair	Carrying	Fair
	Amount	Value	Amount	Value
	£ million	£ million	£ million	£ million
Non Trading				
Derivatives		6		
Total Non Trading		6		

Fair values in respect of non trading financial assets and liabilities are disclosed only where there is a liquid and active market.

Notes to the Accounts (Continued)

25. Effective interest rates

	2005
	Yield %
Assets	
Loans and advances to customers	6.95%
Investment securities	3.74%
Liabilities	
Customer accounts	3.91%
Other borrowed funds:	
Preference shares	9.38%
Subordinated liabilities	5.61%

The above figures do not take account of derivative interest rate hedging and so may not reflect economic margins earned.

Notes to the Accounts (Continued)

26. Interest rate sensitivity gap

	As at 31 December 2005									
	Up to 1 months £ million	Up to 3 months £ million	3 to 12 months £ million	1 to 2 years £ million	2 to 3 years £ million	3 to 4 years £ million	4 to 5 years £ million	over 5 years £ million	Non interest bearing Items £ million	Total £ million
Assets										
Loans and advances to banks	626	34	226	132						1,018
Loans and advances to customers	9,406	1,559	3,461	2,498	1,083	431	138	298		18,874
Investment securities								7		7
Other assets									280	280
	10,032	1,593	3,687	2,630	1,083	431	138	305	280	20,179
Liabilities										
Deposits by banks	9,466	1,086	3,044	2,555	1,252	484	174	412		18,473
Customer accounts	33									33
Other liabilities									287	287
Other borrowed funds		643						136		779
Shareholders' funds									607	607
	9,499	1,729	3,044	2,555	1,252	484	174	548	894	20,179
Total interest rate sensitivity gap	533	(136)	643	75	(169)	(53)	(36)	(243)	(614)	
Cumulative interest rate sensitivity gap	533	397	1,040	1,115	946	893	857	614		

In line with the requirements of IFRS 1 'First time adoption of International Financial Reporting Standards' the following interest rate sensitivity gap table for 2004 has been disclosed as previously reported under the previous GAAP. Subsequent adjustments made to these balances at the date of transition to IFRS are disclosed in note 35.

As at 31 December 2004							
	Not more than 3 months £ million	Over 3 months but not over 6 months £ million	Over 6 months but not over 1 year £ million	Over 1 year but not over 5 years £ million	Over 5 years £ million	Non-interest bearing £ million	Total £ million
Assets							
Loans and advances to banks	436		100	420		27	983
Loans and advances to customers	14,739	475	692	3,422	166		19,494
Debt securities and equity shares					7		7
Other assets						318	318
	15,175	475	792	3,842	173	345	20,802
Liabilities							
Deposits by banks	11,405	1,175	1,786	4,295	341		19,002
Customer accounts	49						49
Other liabilities						438	438
Subordinated liabilities	643						643
Shareholders' funds						670	670
	12,097	1,175	1,786	4,295	341	1,108	20,802
On-balance sheet gap	3,078	(700)	(994)	(453)	(168)	(763)	
Net interest rate gap	3,078	(700)	(994)	(453)	(168)	(763)	
Cumulative gap	3,078	2378	1384	931	763		

Notes to the Accounts (Continued)

27. Non trading currency exposure

There is no activity in foreign exchange outside of the non-trading book and the following table illustrates that, with the inclusion of foreign exchange swap derivative instruments, the underlying exposure to foreign currency is minimal.

Transaction currency exposures

	As at 31 December 2005		As at 31 December 2004	
	US\$	Total	US\$	Total
	£ million	£ million	£ million	£ million
Functional Currency of operation involved:				
Sterling	27	27	23	23

The US\$ denominated balances receivable are the subject of a currency swap contract, as disclosed in note 22.

There were no structural currency exposures as at 31 December 2005 (2004 £nil).

28. Assets and liabilities in foreign currencies

	As at 31 December 2005		
	Euro	US\$	Total
	£ million	£ million	£ million
Assets			
Loans and advances to customers	32	267	299
Operating lease assets		7	7
Prepayments and accrued income		32	32
Total assets	32	306	338
Liabilities			
Other liabilities, including tax liabilities	66	229	295
Total liabilities	66	229	295
			2004
			£ million

The aggregate amounts of assets and liabilities denominated in currencies other than sterling were

Assets	332
Liabilities	271

The above figures do not reflect the Company's exposure to foreign exchange, which is significantly lower as it is hedged by off-balance sheet instruments.

Notes to the Accounts (Continued)

29. Maturity analysis of assets and liabilities

The table below breaks down the Company's assets and liabilities by remaining contractual maturity. The maturity profile for those assets and liabilities defined as 'financial' have been determined in accordance with groupings that are considered most appropriate for those particular assets and liabilities. The remaining assets and liabilities have been split between those considered to be current and non-current.

	As at 31 December 2005					Total
	Up to	1 to 3	3 to 12	1 Year to	Over 5	
	1 month	months	months	5 years	years	
	£ million	£ million	£ million	£ million	£ million	£ million
Assets						
Cash and balances with central banks			26			26
Derivative assets	1			1	6	8
Loans and advances to banks	626	34	226	132		1,018
Loans and advances to customers	11,578	617	2,304	4,173	202	18,874
Investment securities					7	7
Total financial assets	12,205	651	2,556	4,306	215	19,933
Liabilities						
Deposits by banks	8,148	2,497	3,009	4,412	407	18,473
Customer accounts	6	2	7	17	1	33
Derivative liabilities	1	1	6	1	8	17
Other borrowed funds	164	55		424	136	779
Total financial liabilities	8,319	2,555	3,022	4,854	552	19,302

	As at 31 December 2004					Total
	Up to	1 to 3	3 to 12	1 Year to	Over 5	
	1 month	months	months	5 years	years	
	£ million	£ million	£ million	£ million	£ million	£ million
Assets						
Cash and balances with central banks			27			27
Loans and advances to banks	437		131	388		956
Loans and advances to customers	12,607	537	1,739	4,307	290	19,480
Investment securities					7	7
Total financial assets	13,044	537	1,897	4,695	297	20,470
Liabilities						
Deposits by banks	10,487	1,146	2,762	4,229	378	19,002
Customer accounts	49					49
Other borrowed funds				332	311	643
Total financial liabilities	10,536	1,146	2,762	4,561	689	19,694

Notes to the Accounts (Continued)

30. Related party transactions

The ultimate parent of the Company is HBOS plc. A number of banking transactions are entered into with its subsidiaries in the normal course of business. These include loans, deposits and foreign currency transactions. The net interest income received was £602 million (2004 - £628 million). Loans and advances to banks comprise balances owed by related parties of £1,018 million (2004 - £956 million) and deposits by banks comprise amounts owed to related parties of £18,473 million (2004 - £19,002 million). Disclosed within loans and advances to customers are balances owed to the Company by related parties of £13,984 million (2004 - £14,347 million). HBOS plc is the employer of the personnel working for the Company and staff and other costs amounting to £87 million were recharged to the Company.

31. Transactions with key management personnel

The Directors of the Company are considered to be the key management personnel. There were no transactions during 2005 between CAPITAL BANK plc and key management personnel.

32. Segmental analysis

The Directors are of the opinion that the Company operates, to a material extent, in one class of business being the provision of financial services in the United Kingdom, and accordingly a segmental analysis is not provided.

33. Ultimate parent undertaking

The Governor and Company of the Bank of Scotland heads the smallest group into which the accounts of the Company are consolidated. The accounts of the Governor and Company of the Bank of Scotland may be obtained from its head office at The Mound, Edinburgh EH1 1YZ.

HBOS plc is the ultimate parent undertaking of CAPITAL BANK plc and heads the largest group into which the accounts of the Company are consolidated. The consolidated accounts of HBOS plc may be obtained from its head office at The Mound, Edinburgh EH1 1YZ.

34. Explanation of Transition to IFRS

As stated in the 'Statement of compliance' within the Accounting Policies on page 8-10, these are the Company's first financial statements prepared in accordance with IFRS.

In preparing the opening IFRS Balance Sheet, the Company has adjusted amounts previously reported in financial statements prepared in accordance with previous GAAP. An explanation of how the transition from this previous GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in notes 35 and 36 below.

Notes to the Accounts (Continued)

35. Reconciliation of UK GAAP Balance Sheet to IFRS

The balance sheet below explains the restatement of the balance sheet at 31 December 2004 from UK GAAP to IFRS. The restated IFRS balance sheet excludes the application of IAS 32, IAS 39 and IFRS 4.

As At 31 December 2004		IFRS Adjustments			
	Notes	UK GAAP £ million	Reclassification £ million	Adjustment to equity £ million	IFRS £ million
Assets					
Cash and balances at central banks		27			27
Loans and advances to banks		956			956
Loans and advances to customers	a, f	19,494		(14)	19,480
Investment securities	e	7			7
Interests in jointly controlled entities	b	5			5
Interests in subsidiary undertakings		50			50
Goodwill and other intangible assets	c		1		1
Property and equipment		56			56
Operating lease assets		7			7
Other assets		158	6	(74)	90
Deferred tax assets		16	(7)		9
Prepayments and accrued income		26			26
Total assets		20,802		(88)	20,714
Liabilities					
Deposits by banks		19,002			19,002
Customer accounts		49			49
Current tax liabilities			18		18
Other liabilities		147	(18)	(120)	9
Accruals and deferred income		291			291
Subordinated liabilities		643			643
Total liabilities		20,132		(120)	20,012
Shareholders' equity					
Issued share capital		200			200
Share premium		3			3
Retained earnings		467		32	499
Shareholders' equity		670		32	702
Total liabilities and shareholders' equity		20,802		(88)	20,714

Notes to the Accounts (Continued)

Table (I) Reconciliation of equity

	At 31 December 2003 and 1 January 2004	Movement in year ended 31 December 2004	At 31 December 2004
	Equity £million	Retained profits £million	Equity £million
Under UK GAAP	669	1	670
IFRS adjustment			
Leasing	(14)		(14)
Dividends		46	46
	(14)	46	32
Under IFRS as at 1 January 2005	655	47	702

Notes to the Accounts (Continued)

36. Reconciliation of UK GAAP Balance Sheet to IFRS

The balance sheet below explains the restatement of the balance sheet at 31 December 2004 to include the application of IAS 32/39.

As At 31 December 2004		IFRS Adjustments			IFRS as at 1 January 2005
	Note	As at 31 December 2004 £ million	Reclassification £ million	Adjustment to equity £ million	£ million
Assets					
Cash and balances at central banks		27			27
Derivative assets	g		7		7
Loans and advances to banks		956			956
Loans and advances to customers	a,f	19,480	(7)	26	19,499
Investment securities	e	7			7
Interests in jointly controlled entities	b	5			5
Interests in subsidiary undertakings		50			50
Goodwill and other intangible assets	c	1			1
Property and equipment		56			56
Operating lease assets		7			7
Other assets		90	1		91
Deferred tax assets		9	(1)		8
Prepayments and accrued income		26			26
Total assets		20,714		26	20,740
Liabilities					
Deposits by banks		19,002			19,002
Customer accounts		49	(5)	2	46
Derivative liabilities	g		5		5
Current tax liabilities		18			18
Other liabilities		9			9
Accruals and deferred income		291	(6)		285
Other borrowed funds	h	643	136		779
Total liabilities		20,012	130	2	20,144
Shareholders' equity					
Issued share capital		200	(130)		70
Share premium		3			3
Retained earnings		499		24	523
Shareholders' equity		702	(130)	24	596
Total liabilities and shareholders' equity		20,714		26	20,740

Notes to the Accounts (Continued)

Table (II) Reconciliation of equity

	Equity £ million
Under IFRS At 31 Dec 2004	702
Loan fees, cost recognition and interest on an effective yield basis	24
Hedging and derivatives	
	726
Reclassification of preference shares	(130)
Under IFRS	596

Reconciliation of UK GAAP Profit and Loss to IFRS Income Statement for the year ended 31 December 2004

	UK GAAP £ million	IFRS Adjustments £ million	IFRS £ million
Net interest income	223	(37)	186
Non interest income	120	1	121
Net operating income	343	(36)	307
Operating expenses	(142)	1	(141)
Impairment on investment securities			
Operating profit before provisions	201	(35)	166
Impairment losses on loans and advances	(47)		(47)
Non operating income	4		4
Profit before tax	158	(35)	123
Tax on profit	(25)		(25)
Profit after taxation	133	(35)	98

Notes To The Analysis Of The Income Statement, Balance Sheet And Equity Impact

IFRS adjustments - excluding IAS 32 and IAS 39

Detailed below are supplementary notes that provides explanations of the income statement, balance sheet reclassifications and equity impact to reserves as a result of the transition to IFRS. The explanations have been split between excluding and including IAS32 and IAS39 to support the respective Balance sheets in Note 35/36.

a) Leasing

Finance leases

Under the UK GAAP the Company held finance lease assets on the balance sheet within loans and advances to customers at an amount equal to the net investment in the lease after making provisions for items such as bad and doubtful rentals receivable. The total gross earnings under a finance lease were allocated to accounting periods to give a constant periodic rate of return to the lessor's net investment outstanding in respect of the lease. Under IFRS the total gross earnings are allocated to accounting periods using an actuarial pre tax method to give a constant rate of return on the net cash investment.

Operating leases

For operating leases, rental income continues to be recognised on a straight-line basis. However, the calculation of the depreciation on operating lease assets has changed from a post tax actuarial method to a straight-line pre tax basis. This is to ensure that the depreciation profile matches that of similar assets for use by the Company.

b) Interests in jointly controlled entities (JCEs)

IFRS requires investments in debt securities issued by the JCEs to be disclosed separately from the underlying carrying value of these entities. This resulted in a reclassification of debt securities to investment securities. In addition under IFRS losses should be restricted to a level that reflects an obligation to fund such losses, whereas under UK GAAP losses were taken beyond this level.

c) Goodwill and other intangible assets

Impairment reviews for intangible assets with indefinite useful lives are undertaken bi-annually. Goodwill amortisation under IFRS is prohibited.

Software development costs are capitalised in line with our accounting policy and reclassified to goodwill and other intangible assets. Amortisation is carried out on the same basis as under UK GAAP.

d) Dividends paid and payable

Under IFRS ordinary dividends paid in the year are not included on the face of the income statement, but are recognised directly in the retained earnings reserve.

In addition, under IFRS the Company does not recognise ordinary dividends that have been declared or proposed after the balance sheet date. The liability for outstanding distributions on preference shares at the balance sheet date is due to the Company's contractual obligation to pay distributions due on these preference securities.

e) Investment securities reclassification

Both equity shares and debt securities are included within investment securities.

IAS 39 established specific categories into which all financial assets and liabilities must be classified. The classification of financial instruments dictates how these assets and liabilities are subsequently measured in the financial statements. There are four categories of financial assets: Assets at fair value through income statement, available for sale, loans and receivables and held to maturity. The Company does not have any financial instruments designated as fair value through the income statement or held to maturity.

Available for sale financial assets ('AFS')

These are any non-derivative financial assets designated on initial recognition as available for sale. AFS assets are measured at fair value in the balance sheet. Fair value changes on AFS assets are recognised directly in equity, through the SORIE, except for interest on AFS assets (which is recognised in income on an effective interest rate basis), impairment losses, and (for interest-bearing AFS debt instruments) foreign exchange gains or losses. The cumulative gain or loss that was recognised in equity is recognised in the income statement when an available-for-sale financial asset is de-recognised.

Loans and receivables

These are non-derivative financial assets with fixed or determinable payments, originated or acquired, that are not quoted in an active market, not held for trading, and not designated on initial recognition as assets at fair value through the income statement or as available-for-sale. Investment debt securities that are not quoted on an active market are categorised as loans and receivables.

Notes To The Analysis Of The Income Statement, Balance Sheet And Equity Impact (Continued)

f) Loans and advances

Loans and advances are held at amortised cost with revenue recognised on an effective interest rate basis.

The opening IFRS adjustment to reserves in respect of impairment reflects the net impact of moving to a narrower interpretation of an incurred loss model which recognises recoverable cash flows applying a discount rate based on the loan's effective interest rate.

g) Derivatives/hedge accounting

Hedging the Company's exposures to interest rate and foreign exchange rate risk is undertaken in the normal course of business by using derivatives. This activity is principally carried out in Treasury within a risk management framework of limits, practices and procedures set and overseen by the HBOS Group Asset and Liability Committee.

IAS 39 requires the fair value of all derivatives to be recorded on the balance sheet with any movements in value taken to the income statement as they arise. Given that fair values will fluctuate, these movements will create volatility in reserves and the income statement. Only in circumstances where hedge accounting for derivatives is employed will the income statement be protected from this volatility.

The hedge accounting strategy being adopted by the Company is to utilise a combination of both the macro cash flow and micro fair value approaches. In the case of the macro cash flow approach, the hedging derivative is measured at fair value with any movement taken to reserves. In these circumstances no fair value accounting entries are required of the hedged loans or deposits. This approach gives rise to volatility in reserves but protects the income statement to the extent the hedge is effective.

In addition the Company will also use the micro fair value approach which requires that the hedging derivative is measured at fair value with movements recognised in the income statements, rather than reserves. The designated hedge item is also adjusted by the change in fair value in relation to the risk being hedged and that change is recognised through the income statement. Therefore, if the hedge is fully effective, postings to the income statement will be equal and opposite.

h) Reclassification of funding instruments

There is a classification switch of certain funding instruments historically shown within capital and reserves, to other borrowed funds. This arises because the IFRS definition of debt includes instruments with a contractual obligation to pay interest or principal.