CAPITAL BANK plc

REPORT AND ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2006

Company Number 392902

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Business and Financial Review

Introduction

The Directors are pleased to present the results of CAPITAL BANK plc for the year ended 31 December 2006 CAPITAL BANK plc (the 'Company') is a subsidiary of Bank of Scotland Group and its ultimate holding company is HBOS plc

Company profit before tax amounts to £148 million (2005 - £269 million)

Basis of Preparation

The CAPITAL BANK plc financial information has been included in the following Financial Review

Business Sector Analysis of Results

Following an internal reorganisation, from 1 July 2005 HBOS Group reports its results through five divisions (Retail, Corporate, Insurance & Investment, International and Treasury & Asset Management) plus Group Items The business sectors within CAPITAL BANK plc mirror the business sectors of the HBOS Group and have been similarly organised For CAPITAL BANK plc, with the exception of Retail and Corporate, the activities of the other business sectors are not of a sufficient scale to be separately reported and so have been amalgamated for segmental reporting purposes as Other

Key Performance Indicators

The Company has identified three key performance indicators covering efficiency (cost income ratio), growth (advances to customers) and capital usage (capital ratios)

Business And Financial Review (continued)

Overview of Results

Group underlying profit before tax amounts to £148 million (2005 - £269 million) This decrease is primarily due to a decrease in dividends received from subsidiary companies On a divisional basis, group underlying profit before tax is made up as follows -

	Year ended 31 December 2006 £ million	Year ended 31 December 2005 £ million
Retail	**105**	137
Corporate	**37**	135
Other	**6**	(3)

	Year ended 31 December 2006 £ million	Year ended 31 December 2005 £ million
Net interest income	**136**	140
Non interest income	**233**	317
Net operating income	**369**	457
Non-operating income		20
Operating expenses	**(159)**	(149)
Impairment on loans and advances to customers	**(62)**	(59)
Net operating profit	**148**	269

Net interest income for the year was £136 million due to market pressures

	Year ended 31 December 2006 £ million	Year ended 31 December 2005 £ million
Interest receivable	**1,057**	1,086
Interest payable	**(921)**	(946)
Net interest income	**136**	140

Business And Financial Review (continued)

Non-interest income amounted to £233 million for the year compared with £337 million for the year to 31 December 2005

	Year ended 31 December 2006 £ million	Year ended 31 December 2005 £ million
Net fees and commission income	9	15
Dividend income from subsidiary undertakings	207	293
Net trading income	2	(1)
Other operating income	15	10
Non-operating income		20
Non-interest income	233	337

Operating expenses increased 7 per cent to £159 million

	Year ended 31 December 2006 £ million	Year ended 31 December 2005 £ million
Staff costs	73	80
Accommodation, repairs and maintenance	9	8
Technology	5	5
Marketing and communication	26	31
Depreciation		
Property and equipment and intangible assets other than goodwill	9	9
Operating lease assets	1	1
Other	36	15
	159	149

A key performance indicator is the cost income ratio which is 43 % (2005 32%)

Balance Sheet

Gross advances to customers increased by 1 per cent to £19,243 million The mix of the group's lending portfolio at the year end is summarised in the following table and gross lending exposure is shown in more detail in note 7 on page 34

	Year ended 31 December 2006		Year ended 31 December 2005	
Gross advances	£ million	%	£ million	%
Commercial	16,129	84	16,170	85
Personal	3,114	16	2,854	15
Total	19,243	100	19,024	100

Business And Financial Review (continued)

A key performance indicator is the regulatory capital ratios CAPITAL BANK plc is reported on a regulatory basis within Capital Bank solo consolidated figures which are detailed below

	31 December 2006	31 December 2005
	£000	£000
Total risk weighted assets	**10,609**	10,427
Tier 1 capital	**667**	778
Tier 2 capital	**552**	617
Supervisory deductions	**(59)**	(61)
Total Capital	**1,160**	1,334
Tier 1 capital ratio (%)	**6.29**	7 46
Tier 2 capital ratio (%)	**10.93**	12 80

Future Developments

We will continue to sharpen our focus on our core markets to enhance our depth of knowledge and experience By concentrating our attention on markets where we have expertise, we will continue to develop long term relationships with our chosen customers Easy to understand, competitively priced products, and rigorously controlled cost growth and risk management, will enable us to drive both customers advocacy and growth in shareholder value

It is expected that, during the financial year ending 31 December 2007, the businesses now carried on by CAPITAL BANK plc, Halifax plc and HBOS Treasury Services plc, including all their property and liabilities, will be transferred to the Governor and Company of the Bank of Scotland The Governor and Company of the Bank of Scotland will become registered under the Companies Act 1985 and will change its corporate name to Bank of Scotland plc These changes will be effected pursuant to the HBOS Group Reorganisation Act 2006 which received Royal Assent on 22 June 2006

Risk Management

Introduction

CAPITAL BANK plc is a subsidiary of Bank of Scotland Group and its ultimate holding company is HBOS plc The risk management strategy for HBOS is detailed below

Identification, measurement and management of risk is a strategic priority for HBOS The provision of financial services carries a number of diverse risks which may have a material impact on financial performance Consequently, the board has established a comprehensive framework covering accountability, oversight, measurement and reporting to maintain high standards of risk management throughout the Group

The principal risks faced by HBOS are

– Credit Risk - the risk of financial loss from a customer's failure to meet obligations as they fall due

– Market Risk - defined as the potential loss in value or earnings arising from changes in external market factors such as interest rates, foreign exchange rates, commodities and equities or the potential for customers to act in a manner which is inconsistent with business, pricing and hedging assumptions

– Liquidity or Funding Risk - the risk that the Group does not have sufficient financial resources to meet its obligations when they are due, or will have to do so at excessive cost

– Operational Risk - arising from internal processes, people and systems or from external events

- Regulatory Risk – the risk to HBOS strategy, reputation and financial position arising from failure to meet laws, regulations or business standards in the jurisdictions and businesses in which we operate

This report has been audited by KPMG Audit plc from the section entitled "Credit Risk" on page 8 to the end of the section on "Liquidity Risk" on pages 11 and 12

Management and Controls

Principles

Within the Group, risk is managed in accordance with the following principles

– Key risks are identified, measured where appropriate, and managed to achieve a balance between risk and reward, which is acceptable to the Board Each year the Board carries out a formal strategic review of risk management, and also reassesses its appetite for risk in light of the Group's annual business plan This focus on aligning the taking of risk with the achievement of business objectives means that the control system is designed to manage, rather than eliminate, risk and can provide only reasonable – and not absolute – assurance against material misstatement or loss The Board also reviews risk management performance through regular management information reporting

– Responsibility for risk is a key element of managers' competencies at all levels For each major risk type, specialist teams have been established where appropriate, both in the divisions and at Group level, to ensure that guidance is available for managers within the Group Specialist risk managers are tasked with researching industry best practice, and with ensuring that standards and policies within the Group are progressively developed to improve risk management practice

- Staff and systems resources are dedicated to ensuring that risk management information is accurate, timely and relevant to the business, reflecting the true position at any given time

The Board has overall responsibility for the Group's system of control and approval of principal risk policies and standards, which are continually evolving The Board is also responsible for reviewing the effectiveness of the systems and controls The system of controls described in this section has been in place throughout the period to the date of approval of the Annual Report & Accounts It accords with the Turnbull guidance on internal control and has also been reviewed by the Board specifically for the purposes of this statement

The Risk Management Framework

HBOS allocates specific roles in the management of risk to executives and senior managers and to the Board and Executive Committees This is undertaken within an overall framework and strategy established by the Board The model is based on the concept of "three lines of defence"

– Within operating divisions, primary management responsibility for strategy, performance management and risk control lies with the Divisional Chief Executives (first line of defence) They have responsibility for managing strategic, market, credit, liquidity, regulatory and operational issues and risks affecting their own operations within the parameters of Group policies Each business division also has its own risk management committee or committees

Risk Management (continued)

– Centralised policies and standards are developed and objective oversight of risk management is exercised by specialist risk functions, supporting the Group's Executive Committees and Executive Risk Committees (second line of defence), and

– Independent and objective assurance on the effectiveness of control systems is provided by Group Internal Audit with oversight by the Audit Committee (third line of defence)

This model operates through a formal governance structure, comprising committees with specified areas of responsibility, supported by management functions with a similar remit

The Committee Framework

The Group Executive Risk Committees develop the policies and parameters within which business divisions are required to manage risk The Committees provide central oversight by reviewing and challenging the work of the business divisions' own risk committees and by providing functional leadership in the development and implementation of risk management techniques

The four specific Executive Risk Committees are

– Group Credit Risk Committee, which covers all credit risk matters,

– Group Market Risk Committee, which is responsible for all trading and market risk matters,

– Group Insurance Risk Committee, which is responsible for insurance risks, within the insurance and investment businesses, and

– Group Operational Risk Committee, responsible for operational and regulatory risks

The Group has an established specialist Group Risk function, reporting to the Group Risk Director, in support of these Committees Its accountabilities are

– to recommend Group policies, standards and limits,

– to monitor compliance with those policies, standards and limits, and

– to aggregate risks arising in the business divisions and to monitor the overall Group position independently from the divisions' own analysis

Consideration of capital, liquidity and balance sheet management is undertaken on an integrated basis All capital and funding related activities are the responsibility of the Group Capital Committee, supported by three sub-committees, which focuses on the core aspects of overall Group requirements The Group Capital Committee is chaired by the Group Finance Director and operates under delegated authority from the Board, to

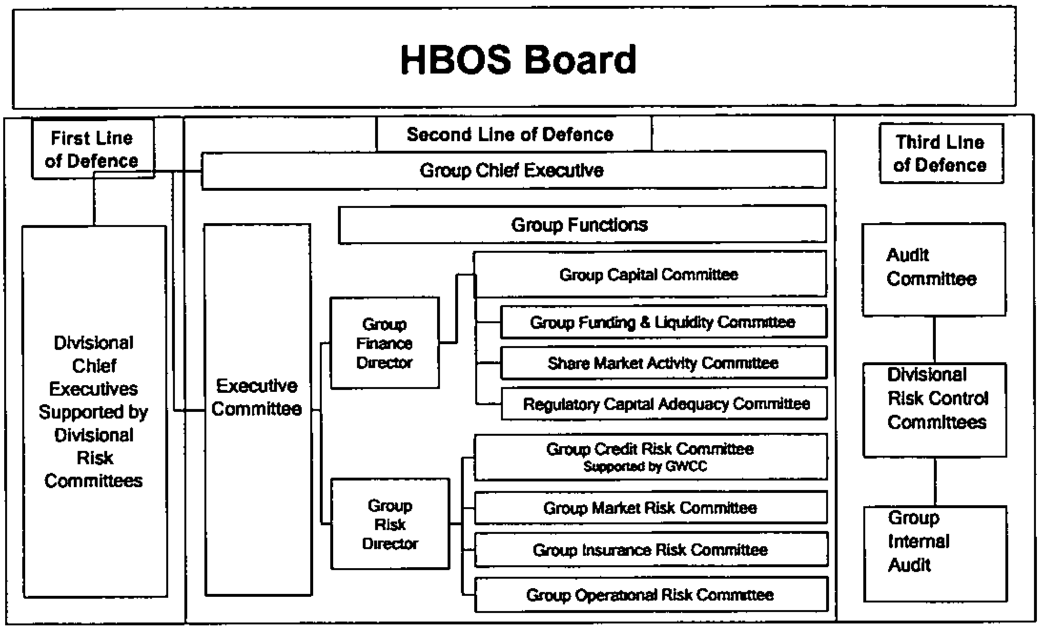
– Oversee and manage the Group's Balance Sheet and Capital in accordance with the Board approved Group Business Plan through

> – Establishing and monitoring compliance with the Group's Capital Plan in line with the Board Approved Group Capital Policy
>
> – Establishing and monitoring compliance with the Group Funding Plan
>
> – Establishing policies and minimum standards to measure and monitor the financial resource requirements of the Group in accordance with regulatory requirements, including
>
> – Establishing and monitoring execution of strategies for the management of non-trading related balance sheet risks within approved risk appetite, policy and minimum standards (as monitored by the Group Market Risk Committee),
>
> – Establishing and reviewing stress, scenario and contingency planning and management strategies in that regard (in co-operation with the Executive Risk Committees)

Risk Management (continued)

- Establish and recommend for approval to the Board, the Group's appetite for Liquidity Risk, including relevant policy (Group Liquidity Policy Statement) and minimum standards and monitoring the implementation of those policies and standards within the HBOS Group

Risk Management Structure



Risk Control and Oversight

The Group's risk appetite is established by the Board The strategy for managing risk is formulated by the Executive Committee and recommended to the Board for approval The Executive Committee also reviews the effectiveness of risk management systems through reports from management and the Group Executive Risk Committees

Divisional management has primary responsibility for identifying and evaluating significant risks to the business and for designing and operating suitable controls Internal and external risks are assessed, including economic factors, control breakdowns, disruption of information systems, competition and regulatory requirements The assessment process is designed to be consistent across the divisions and Group Functions and uses an iterative challenge process to provide successive assurances to ascending levels of management up to the Board

In judging the effectiveness of the Group's controls, the Board reviews the reports of the Audit Committee and management It also considers key performance indicators and reviews monthly financial and business performance showing variances against budget Certain responsibilities are delegated to the Audit Committee, including ensuring that there is regular review of the adequacy and efficiency of internal control procedures This role provides independent and objective assurance that there is an appropriate control structure throughout the Group The Audit Committee, which is supported by Divisional Risk Control Committees, obtains assurance about the internal control and risk management environment through regular reports from Group Risk and Group Internal Audit It also considers external auditors' reports and reviews the minutes and work of the Divisional Risk Control Committees

The Basel II Accord

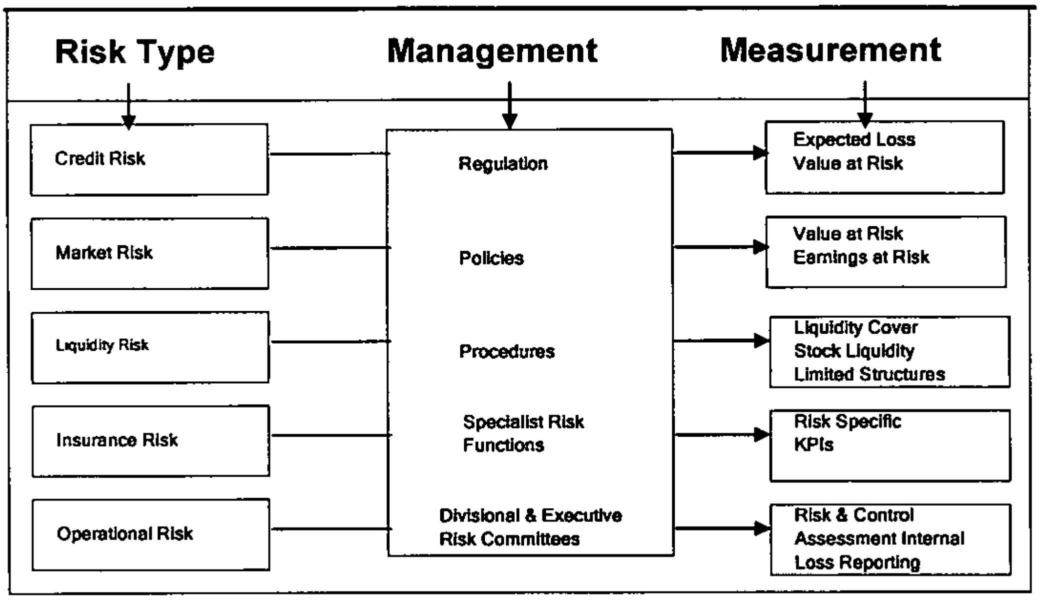
HBOS continues to make good progress with Basel II preparations The primary goal of our programme has always been to optimise the way we do business through an improved risk management capability The overarching objective of all HBOS activity is to deliver sustainable income streams and generate added shareholder value and the Basel II programme is integral to our strategy of targeted growth During 2006 the UK legislative process gathered significant momentum with the publication of several consultative papers and feedback statements that culminated on 25 October 2006 with the Financial Services Authority (FSA) Board approving final GENPRU and BIPRU rules for adoption

Risk Management (continued)

into the Prudential Sourcebook for Banks, Building Societies and Investment Firms This legislative process enacts the European Capital Requirements Directive and, therefore, the Basel II Capital Accord, in the UK with effect from 1 January 2007 HBOS continues to promote a prudent and responsible approach to the management of capital and has elected to adopt transitional arrangements in 2007 and remain on the current Basel I rules to determine minimum regulatory capital requirements HBOS submitted Advanced Internal Ratings Based Approach and Advanced Measurement Approach waiver applications in December 2006 to the FSA and is seeking approval to adopt the most sophisticated approaches to capital determination from 1st January 2008 We continue to maintain a close dialogue with the FSA to work through the accreditation process

Management of Key Risks

The HBOS Group is committed to developing its risk management techniques and methodologies, both to maintain high standards of risk management practice and to fulfil the requirements of UK and international regulators



Credit Risk

Credit Risk is the risk of financial loss from counterparty's failure to settle financial obligations as they fall due

The Group Credit Risk Committee, one of the Executive Risk Committees, is chaired by the Group Risk Director and comprises senior executives from across the business divisions and group functions It meets monthly and reviews the Group's lending portfolio It also assists the Board in formulating the Group's credit risk appetite The Group Credit Risk Policy Statement, to be applied across all businesses subject to credit risk, is approved by the Board on an annual basis

Group Credit, a specialist support function within Group Risk, provides centralised expertise in the area of credit risk measurement and management techniques

In addition to reporting on the performance of each divisional portfolio to the Group Credit Risk Committee, Group Credit exercises independent oversight over the effectiveness of credit risk management arrangements and adherence to agreed policies, standards and limits

Day to day management of credit risk is undertaken by specialist credit teams working within each Division in compliance with policies approved by the Board Typical functions undertaken by these teams include credit sanctioning, portfolio management and the management and collection of high risk and defaulted accounts

Risk Management (continued)

To mitigate credit risk, a wide range of policies and techniques are used across the Group

– For Retail portfolios use is made of software technology in credit scoring new applications In addition, where practical, behavioural scoring is used to provide an assessment of the conduct of a customer's accounts in granting extensions to, and setting limits for, existing facilities Affordability is an increasingly important measure and is reviewed in combination with either application and/or behavioural scores Collections activity for credit card, current accounts and personal loans is centralised for the various products and software systems are used to prioritise action Mortgage collection is conducted through a number of payment collection departments Small business customers may be rated using scorecards in a similar manner to retail customers

– For Corporate portfolios, a full independent credit assessment of the financial strength of each potential transaction and/or customer is undertaken, awarding an internal credit risk rating Internal ratings are reviewed regularly The same approach is also used for larger SME (small to medium enterprise) customers

– Within HBOS Treasury Services plc (HBOSTS), largely incorporating the Group's wholesale, sovereign and banking related exposures, focused credit risk policies are established and reviewed by the Group Wholesale Credit Committee ('GWCC'), a subcommittee of the Group Credit Risk Committee

An additional measure within the credit risk framework is the establishment of product, industrial sector and country limits to avoid excessive concentrations of risk particularly within volatile economic sectors or individual countries Material portfolio areas, such as the mortgages portfolios, have approved sub-sector limits to ensure that they remain within our plans and tolerance for risk All such limits are set and monitored by the Group Credit Risk Committee The controls applied to lending assessment processes consider environmental risk and the potential impact this may have on the value of the underlying security

Standards have been established across the Group for the management of credit risk All divisions are committed to continuously improving credit risk management and there have been significant levels of investment in the development of credit risk rating tools, including portfolio risk measurement systems in preparation for the introduction of the Basel II Accord

Market Risk

Market risk is defined as the potential loss in value or earnings of the organisation arising from.

– changes in external market factors such as interest rates (interest rate risk), foreign exchange rates (foreign exchange risk), commodities and equities, and

– the potential for customers to act in a manner which is inconsistent with business, pricing and hedging assumptions

The objectives of the Group's market risk framework are to ensure that

– market risk is taken only in accordance with the Board's appetite for such risk,

– such risk is within the Group's financial capability, management understanding and staff competence,

– the Group complies with all regulatory requirements relating to the taking of market risk,

– the quality of the Group's profits is appropriately managed and its reputation safeguarded, and

– appropriate information on market risk is known to those making decisions, such that the taking of market risk is designed to enhance shareholder value

Risk appetite is set by the Board which allocates responsibility for oversight and management of market risk to the Group Market Risk Committee, one of the Executive Risk Committees, and chaired by the Group Risk Director

The Group devotes considerable resources to ensuring that market risk is comprehensively captured, accurately modelled and reported, and effectively managed Trading and non-trading portfolios are managed at various organisational levels, from the HBOS Group overall, down to specific business areas

Market risk measurement and management methods are designed to meet or exceed industry standard, and the tools used facilitate internal market risk management and reporting, as well as external disclosure requirements

Market risk is controlled across the Group by setting limits using a range of measurement methodologies The principal methodologies are Value-at-Risk ("VaR"), Earnings-at-Risk ("EaR") and scenario analysis EaR is a technique that provides estimates of the potential negative change in the forecast earnings of a portfolio over a specified time horizon VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a

Risk Management (continued)

specified time horizon at given confidence levels Scenario analysis is performed in order to estimate the potential economic loss that could arise from extreme, but plausible stress events In 2006 the Group introduced market value methodology for its banking businesses to expand on the Groups capabilities in capturing market risk

Detailed market risk framework documents and limit structures have been developed for each division These are tailored to the specific market risk characteristics and business objectives of each operating division Each divisional policy requires appropriate divisional sanction, and is then forwarded to the Group Market Risk Committee for approval on at least an annual basis

Group items (centrally managed net free reserves, subordinated debt and structural foreign exchange) are managed within separate policies and limits/mandates, as set by the Group Capital Committee

Interest Rate Risk

The primary market risk faced by the Group is interest rate risk Interest rate risk exists where the Group's financial assets and liabilities have interest rates set under different bases, or which reset at different times

The Board limit for structural interest rate risk is expressed in terms of potential volatility of net interest income in adverse market conditions Risk exposures will be monitored using one or a combination of the following measures
– Net Interest Income at Risk - This methodology combines an analysis of the Group's Interest Rate Risk position overlaid with behavioural assessment and re-pricing assumptions of planned future activity The change to forecast NII is calculated with reference to different interest rates scenarios These scenarios range from next most likely rate move, to a significant parallel shock

– Present Value of a Basis Point ("PVBP") PVBP is a measure of market value sensitivity and quantifies the change in present value of cash flows for a one basis point change in interest rates

– Market Value Measures (Banking Book) - A dynamic balance sheet mark to market is a risk measurement that considers future business and customer behaviour implications to capture the optionality embedded within the banking books
– Duration – Duration provides a single measure of a portfolio's 'average maturity' as calculated when considering all future cash flows of that portfolio, discounted at current market rates

The Board has delegated authority to the Group Market Risk Committee to allocate limits to business areas as appropriate within the overall risk appetite, as approved by the Board each year In turn, the Group Market Risk Committee has granted limits, which represent the risk tolerance for each division Interest rate risk arising in the course of business is required to be transferred to Treasury from the banking divisions The residual risk in the banking divisions is primarily that related either to behavioural characteristics or to basis risk arising from imperfect correlations in the adjustment of rates earned and paid on different instruments with otherwise similar characteristics

Sensitivity to interest rate movements is shown in Note 24 to the Accounts on page 47 which provides the year end repricing profile for the Group's financial assets and liabilities in the non-trading book, which includes lending funding and liquidity activities The methodology used in analysing the year end repricing profile does not take into consideration the effects of behavioural and basis risk issues, hence for internal management of risk the Group relies on a number of methodologies, as described above

Foreign Exchange Risk

The Group Funding & Liquidity Committee is responsible for oversight and management of structural foreign currency risk The Group Funding & Liquidity Committee manages foreign currency exposures based on forecast currency information provided by the Operating Divisions, and mandates Treasury to execute transactions and undertake currency programmes to manage structural currency risk The risk position is monitored monthly by the Group Market Risk Committee

Transaction exposures arise primarily from profits generated in the overseas operations, which will be remitted back to the UK and then converted into sterling Translation exposures arise due to earnings that are retained within the overseas operations and reinvested within their own balance sheet Structural foreign exchange exposures are set out in Note 25 to the Accounts on page 48

Risk Management (continued)

Trading

The Group's market risk trading activities are principally conducted by Treasury This Group activity is subject to a Trading Book Policy Statement, which is approved by the Board, and limits set by the Group Market Risk Committee

Treasury trading primarily centres around two activities proprietary trading and trading on the back of business flows Both activities incur market risk, the majority being interest rate and foreign exchange rate exposure The framework for managing the market risk in these activities requires detailed and tailored modelling techniques, which are the responsibility of the Treasury Market Risk team. The Group employs several complementary techniques to measure and control trading activities including Value at Risk ("VaR"), sensitivity analysis, stress testing and position limits The VaR model used, forecasts the Group's exposure to market risk within an estimated level of confidence over a defined time period The average VaR value in 2006 was 4 2m. The current methodology for providing an aggregated VaR for the business uses conservative assumptions In order to assess the effectiveness of VaR the Group uses a technique known as "back-testing", which compares the daily profit and loss from trading activities to the VaR estimate for that day Daily standard deviation of trading profit and loss was £0 6m. The Group recognises that the VaR methodology cannot guarantee the maximum loss that may be suffered in any trading period, particularly in the event of market turmoil Therefore, stress testing is used to simulate the effect of selected adverse market movements The regulatory capital charge for market risk trading exposures represents only 28 2% of the Group's capital base

Derivatives

In the normal course of banking business, the Group uses a limited range of derivative instruments for both trading and non-trading purposes The principal derivative instruments used are interest rate swaps, interest rate options, cross currency swaps, forward rate agreements, forward foreign exchange contracts and futures The Group uses derivatives as a risk management tool for hedging interest rate and foreign exchange rate risk Examples of how derivatives are used in managing and mitigating market risk exposures arising from banking services and activities are

- Fixed interest rate swaps, to manage the sensitivity of the investment of reserves and other non-interest bearing liabilities to falls in interest rates, and
- Basis swaps are used to manage exposure between 1 month LIBOR and base rates

The Group's activity in derivatives is controlled within risk management limits set by the Board and overseen by the relevant Group Risk Committees This framework recognises the principal risks including credit, operational, liquidity and market risk associated with derivatives Details of derivative contracts outstanding at the yearend are included in Note 6 to the Accounts on pages 32 and 33

Liquidity Risk (Funding)

Liquidity risk is the risk that the Group does not have sufficient financial resources to meet its obligations when they come due, or will have to do so at excessive cost This risk can arise from mismatches in the timing of cashflows relating to assets, liabilities and off-balance sheet instruments

The Group Liquidity Policy Statement is approved by the Board and defines the core principles for identifying, measuring, managing and monitoring liquidity risk across the Group Detailed liquidity risk framework documents and limit structures are in place for the Group's operations in the UK and Australia, where liquidity is managed on a group basis, and for overseas banking units subject to specific regulatory requirements The responsibility to direct the management of liquidity and to report against policy is delegated to the Group Capital Committee Policy is reviewed at least annually to ensure its continued relevance to the Group's current and planned operations Operational liquidity management is delegated to Treasury, the Group Funding & Liquidity Committee (a sub-Committee of the Group Capital Committee) oversees the controls exercised by Treasury The Board requires that prudential liquidity limits should be set by Group Funding & Liquidity Committee, both at aggregate levels and for individual currencies in which the Group has significant wholesale funding These limits are established by way of cashflow mismatch and are quantified over two time horizons – from sight to eight days and from sight to one month For the purpose of calculation, marketable assets are subject to both instrument concentration limits and prudential discount factors An assessment is also made for the possible outflow from customer deposits and committed facilities, determined by prudential behavioural modelling The Group's approach to the management of liquidity goes beyond the Sterling Stock Liquidity approach used by the FSA, in that it includes measures of liquidity cover out to one month, and measures for currencies other than sterling Whilst following this approach, the Group also adheres to the FSA's Sterling Stock Liquidity policy, of which a key element is that a bank should hold a stock of high quality liquid assets that can be sold

Risk Management (continued)

quickly and discreetly in order to replace funding that has been withdrawn due to an actual or perceived problem with the bank The objective is that this stock should enable the bank to continue business, whilst providing an opportunity to arrange more permanent funding solutions The FSA has a prescriptive regime for retail banks that specifies the formula for determining both the quantum and type of assets qualifying for Sterling Stock Liquidity Sterling Stock Liquidity is regarded as a cost of doing business It is not regarded as an operational liquidity pool as it will always be required in case of emergency From an operational perspective, the Group will place greater reliance on market access to funding sources and the retention of a pool of diversified assets that can be sold in an efficient and discreet manner The Group also adheres to the requirements of other regulatory authorities including the Australian Prudential Regulatory Authority and the Irish Financial Regulator in whose jurisdictions the Group has branches or subsidiaries The funding capacity of the Group is dependent upon factors such as the strength of the balance sheet, earnings, asset quality, ratings and market position The Group Funding & Liquidity Committee assesses the Group funding mix to ensure that adequate diversity is maintained It is Group policy to manage its balance sheet profile to ensure customer deposits sourced outside of Treasury represents a significant component of its overall funding, and the Group Funding & Liquidity Committee directs and co-ordinates the activities of the operating divisions in raising liabilities from a range of sources Within Treasury, the Group avoids undue concentration by maintaining both a widespread mix of counterparties and inward credit lines and a core set of bank and non-bank depositor relationships providing a stable source of funding The Group Funding & Liquidity Committee approves the appropriate balance of short to medium term The Group has established a Liquidity Contingency Planning Framework to identify liquidity stress situations at an early stage

Operational Risk

Operational Risk exists in the normal conduct of business Examples of potential sources of operational risk include fraud, system reliability, human error, failure of key suppliers, IT security, business continuity, change management, operational outsourcing and failure to comply with legislation or regulation

The Board has approved an Operational Risk Policy that establishes the framework for managing operational risk The main components of the Operational Risk Framework include risk and control assessment, internal loss reporting, capture of risk event information, key risk indicator monitoring and evaluation of external events

The Group Operational Risk Committee is one of the four Executive Risk Committees chaired by the Group Risk Director It is attended by senior executives from the Divisions and Group specialist areas The committee considers the management of issues and exposures, recommends the appropriate capital requirement, approves policies and standards and provides oversight of the operational risk communities

A key enhancement to our infrastructure has been to focus on the explicit risk management of specialist areas that underpin the HBOS Operational Risk Framework All specialist functions have clear roles defined to help lead the identification, management and measurement of risks relevant to their areas across the Group The Group Operational Risk function co-ordinates the specialist areas, designs and maintains Group-wide risk systems and undertakes the detailed modelling required to assess risk exposure

Regulatory Risk

The Financial Services Authority is the main regulator for HBOS, although the Group's international businesses in the USA, Australia and Ireland are subject to direct scrutiny from the US Federal Reserve, APRA and The Financial Regulator respectively

HBOS understands that consumers have an ever-increasing choice of supplier and product and are more demanding of financial services providers Consumer lobby groups have also become more vociferous on their behalf The Group's Customer Contract, which was approved by the Board in November 2005, sets out principles for doing business and is HBOS's response to the FSA's Treating Customers Fairly initiative The objective is to meet the requirements of our shareholders through meeting the needs of our customers

HBOS is alert to the wider, cumulative picture of regulatory change and utilises centralised expertise in the area of regulatory and legal compliance, specifically to

- Identify and assess the impact of, respond to and where possible influence the direction of regulatory developments on behalf of HBOS,
- Lead the development and monitoring of the application of specific Group-wide policies and standards, and,
- Oversee the management, support and co-ordination of the liaison and interaction with HBOS regulatory stakeholders across all its international businesses

The impact of regulatory change is reported across all Executive Risk Committees with specific reference to the discipline affected and at Group level to Audit Committee and the Board

Directors' Report

The Directors have pleasure in presenting their Report and Accounts for the year ended 31 December 2006 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 37

Business Review

The Companies Act 1985 requires the Directors' Report to include a Business Review giving a fair review of the business of the Company and a description of the principal risks and uncertainties facing the Company

The Company's development and performance during the year, position at the year end and likely future prospects are reviewed in the Business and Financial Review on pages 1 to 4 and the Risk Management report on pages 5 to 12 The information in both of these sections, which fulfils the requirements of the Business Review, is incorporated into this Directors' Report by reference

Results and Dividends

The profit before tax for the year ended 31 December 2006 amounted to £148 million (year ended 31 December 2005 £269 million) During 2006 an interim ordinary dividend of £200 million was paid in respect of the year ended 31 December 2006

Payment Policy

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

For the forthcoming period 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 the date of a correct invoice that has been received 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

HBOS plc complies with the Better Payment Practice Code Information regarding this code and its purpose can be obtained from the Better Payment Practice Group's website at www payontime co uk

The Company had trade creditors outstanding at 31 December 2006 representing 18 days of purchases.

Directors

The current Directors are

J Coyle

P J Cummings

D R Fryatt

J Morris

L Town

A Webster

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 06	Number of shares at 31 12 05 or date of appointment if later
J Coyle	**80,767**	49,938
P J Cummings	**88,791**	71,097
D R Fryatt	**88,246**	70,515
J Morris	**41,445**	28,622
L. Town	**21,203**	11,338
A Webster	**134,463**	100,075

There has been no change in share interests as set out in the table between the end of the financial year and 23 February 2007, the date of approval of this annual report and accounts

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 06
J Coyle	Mar 2004	2,034
	Mar 2005	3,140
	Mar 2006	2 899
P J Cummings	Mar 2004	1,903
	Mar 2005	5,404
	Mar 2006	7,576
D R. Fryatt	Mar 2004	2,275
	Mar 2005	2,953
	Mar 2006	1,918
J Morris	Mar 2004	4,360
	Mar 2005	4,807
	Mar 2006	3,350
A Webster	Mar 2004	2,525
	Mar 2005	5,673
	Mar 2006	4,128

L Town had no short term incentive 'Sharekicker' plans as at 31 December 2006

Directors' Report (continued)

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 2004 – Mar 2007	7 36
Mar 2005 – Mar 2008	8 19
Mar 2006 – Mar 2009	9 86

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

Dırectors' Report (Contınued)

Long-term Incentive Plan– HBOS Scheme

Detaıls of the shares whıch have been condıtıonally awarded to Dırectors under the plans are set out below The performance condıtıons relatıng to these condıtıonal awards are set out ın the notes below the table

Table 3

	Grant effective from	At 31 12 05 or date of appointment if later	Granted (G) or Lapsed (L) in year	Added as a result of performance	Dividend reinvestment shares	Redeemed in year	At 31 12 06
J Coyle	Jan 2003	13,541		12,982	2,101	28,624	
	Jan 2004	13,482					13,482
	Jan 2005	11,904					11,904
	Jan 2006		12,971(G)				12,971
P J Cummıngs	Jan 2003	18,750					18,750
	Jan 2004	27,894					27,894
	Jan 2005	23,809					23,809
	Jan 2006		51,203(G)				51,203
D R Fryatt	Jan 2003	7,708		7,390	1,196	16,294	
	Jan 2004	15,806					15,806
	Jan 2005	13,492					13,492
	Jan 2006		12,288(G)				12,288
J Morrıs	Jan 2003	19,375		18,577	3,007	40,959	
	Jan 2004	21,385					21,385
	Jan 2005	19,444					19,444
	Jan 2006		17,409(G)				17,409
L Town	Jan 2003	6,757		6,478	1,048	14,283	
	Jan 2004	7,670					7,670
	Jan 2005	9,473					9,473
	Jan 2006		15,702(G)				15,702
A Webster	Jan 2003	17,708		16,978	2,748	37,434	
	Jan 2004	18,596					18,596
	Jan 2005	15,873					15,873
	Jan 2006		15,702(G)				15,702

Shares granted under these plans can crystallıse at any level between 0% and 200% of the condıtıonal award noted ın the above table, dependent upon performance The performance perıod for the January 2003 grant ended on December 2005 and, ın lıght of the performance outcome, grants were released at 183% of the condıtıonal award On maturıty, dıvıdend ınvestment shares equıvalent to approxımately 15 5% of the orıgınal grant were also released to partıcıpants ın accordance wıth the rules of the plan

Directors' Report (Continued)

Long-term Incentive Plan – Share Options

The share options under the former Bank of Scotland plans are exercisable in accordance with the rules of the plans, all performance targets having been satisfied D R Fryatt and L Town have share options under the HBOS all-employee plan for which there are no performance conditions

No further share options have been or can be granted under these plans

Details of the options outstanding under these plans in respect of Executive Directors are set out below

Table 4

	Options outstanding at 31 12 05 or date of appointment if later	Granted	Lapsed	Exercised	At 31 12 06
D R Fryatt	27,367			19,000	8,367
L Town	8,598			3,967	4,631
A Webster	26,000				26,000

Sharesave Plan

Share options granted under these plans are set out below

Table 5

	At 31 12 05 or date of appointment if later	Granted	Lapsed	Exercised	At 31 12 06
J Coyle	4,021	355		(1,285)	3,091
P J Cummings	3,606	238		(1,214)	2,630
D R Fryatt	2,868	429		(952)	2,345
J Morris	1,607	1,191		(1,607)	1,191
L Town	1,740				1,740
A Webster	4,277	993			5,270

Dırectors' Report (Contınued)

Free Share Plan

The free share plan ıs avaılable to most Group colleagues

The plan grants colleagues free shares on an annual basıs At the end of three years, shares are transferable to colleagues, subȷect to the partıcıpants stıll beıng ın the Group's employment at that tıme or earlıer ıf they are a qualıfyıng leaver Shares must be held ın trust for five years to qualıfy for full tax and Natıonal Insurance benefits There are no performance condıtıons and as colleagues benefit from the shares durıng the holdıng perıod these shares are also ıncluded ın the beneficıal ınterests dısclosed ın Table 1

All Executıve Dırectors have taken up membershıp of the plan and the proȷected number of shares to whıch they would be entıtled at the end of the relevant perıod are set out below

Table 6

	Grant effectıve from	At 31 12 05 / 01 01 06	Granted (G),Exercısed (E) or Lapsed (L)ın year	Dıvıdend Reınvestment Shares acquıred ın year	At 31 12 06	Releasable
J Coyle	Aug 05	333		14	347	Aug 08
	Aug 06		308 (G)	3	311	Aug 09
P Cummıngs	Aug 05	333		14	347	Aug 08
	Aug 06		308 (G)	3	311	Aug 09
D R Fryatt	Aug 05	333		14	347	Aug 08
	Aug 06		308 (G)	3	311	Aug 09
J Morrıs	Aug 05	333		14	347	Aug 08
	Aug 06		308 (G)	3	311	Aug 09
L Town	Aug 05	333		14	347	Aug 08
	Aug 06		308 (G)	3	311	Aug 09
A Webster	Aug 05	333		14	347	Aug 08
	Aug 06		308 (G)	3	311	Aug 09

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 Only P Cummings is a Director of HBOS

Going Concern

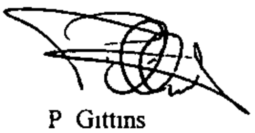
The Directors are satisfied that the company has adequate resources to continue in business for the foreseeable future and consequently the going concern basis continues to be appropriate in preparing the accounts

Auditors

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

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they each are aware, there is no relevant audit information of which the Company's auditors were unaware, and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information

On behalf of the Board



P Gittins

Company Secretary

23rd February 2007

Statement of Directors' Responsibilities in Respect of the Annual Report and the Financial Statements

The Directors are responsible for preparing the Annual Report 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 MEMBERS OF CAPITAL BANK plc

We have audited the company financial statements (the "financial statements") of CAPITAL BANK plc for the year ended 31 December 2006 which comprise the Income Statement, Balance Sheet, Cash Flow Statement, Statement of Recognised Income and Expense 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 auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report, Directors' Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 20

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 are properly prepared in accordance with the Companies Act 1985 We also report to you if, in our opinion, the information given in the Directors' Report is consistent with the financial statements The information given in the Directors' Report includes that specific information presented in the Annual Report that is cross referred from the Business Review section of the Director's Report

In addition we report to you if, in our opinion, 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 the other information contained in the Annual Report 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed

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

Opinion

In our opinion

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements

KPMG Audit plc
Chartered Accountants KPMG Audit Plc 23 February 2007

Registered Auditor

Saltire Court

20 Castle Terrace

Edinburgh

Accounting Policies

Statement of compliance

The 2006 statutory financial statements set out on pages 26 to 50 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

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

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 These entities have not been consolidated In accordance with the exemption afforded by s228 of the Companies Act 1985, consolidated accounts have not been prepared CAPITAL BANK plc is consolidated within Bank of Scotland Group financial statements

Jointly controlled entities

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

The attributable share of results of associated undertakings and jointly controlled entities, generally based on audited accounts, are included in the consolidated financial statements using the equity method of accounting The share of any losses is restricted to a level that reflects an obligation to fund such losses

Designation of Financial Instruments

The Group has designated its financial instruments in accordance with IAS 39 'Financial Instruments Recognition and Measurement' as follows

- Non-derivative financial assets where there is no active market and which have fixed or determinable payments are designated as 'loans and receivables'
- The Group's 'trading' portfolio is designated as 'held for trading'
- Derivative instruments are automatically designated as 'at fair value through the income statement' unless they form part of a hedging relationship
- Instruments that are designated 'on initial recognition to eliminate a mearsurement mismatch or where they contain an embedded derivative which is not separated rom the host contract are designated 'at fair value through the income statement'
- No financial assets are designated as 'held to maturity'
- All financial assets are classified as 'as available for sale'.
- All financial liabilites are classified as 'at amortoised cost'.

The resulting treatment of these financial instruments is set out in the accounting policies below

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

Accounting Policies (continued)

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

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

Accounting Policies (continued)

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 property, 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

Accounting Policies (continued)

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

IFRS Not Yet Applied

The following standards and interpretations have been adopted by the European Union but are not effective for the year ended 31 December 2006 and have not been applied in preparing the consolidated financial statements

IFRS 7 'Financial Instruments Disclosure' and the 'Capital disclosure amendment' to IAS 1 'Presentation of financial statements' which are applicable for periods commencing on or after 1 January 2007 The application of these standards in 2006 would not have affected the balance sheets, income statement or cash flow statements as they are only concerned with disclosure

IFRIC 7 'Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies which is effective for periods commencing on or after 1 March 2006 The application of this Interpretation in 2006 would not have affected the balance sheets, income statement or cash flow statements as the Group does not operate in hyperinflationary economies

IFRIC 8 'Scope of IFRS 2 Share-based Payment' which is effective for periods commencing on or after 1May 2006 The application of this Interpretation in 2006 would not have affected the balance sheets, income statement or cash flow statements as share based payment transactions in the Group are made for the receipt of identifiable services

IFRIC 9 'Reassessment of Embedded Derivatives' which is effective for periods commencing on or after 1 June 2006 The application of this Interpretation in 2006 would not have affected the financial statements because the Group's approach to reassessing embedded derivatives already reflects the requirements of the Interpretation

The following standards and interpretations have not yet been adopted by the European Union, are not effective for the year ended 31 December 2006 and have not been applied in preparing the financial statements

IFRS 8 'Operating Segments' which is applicable for periods commencing on or after 1 January 2009 The application of this standard in 2006 would not have affected the financial statements as it is only concerned with disclosure

IFRIC 10 'Interim Financial Reporting and Impairment' which is effective for periods commencing on or after 1 November 2006 The application of this Interpretation in 2006 would not have affected the financial statements as no reversals to impairment losses within the scope of this Interpretation have been made

IFRIC 11 'Group and Treasury Share Transactions' which is effective for periods commencing on or after 1 March 2007 The application of this Interpretation in 2006 would not have affected the financial statements because the Interpretation deals with accounting for share based payments at subsidiary level

IFRIC 12 'Service Concession Arrangements' which is effective for periods commencing on or after 1 January 2008 The application of this Interpretation in 2006 would not have affected the financial statements

Income Statement

For the year ended 31 December 2006

	Notes	2006 £ million	2005 £ million
Interest receivable		1,057	1,086
Interest payable		(921)	(946)
Net interest income		136	140
Dividend income from subsidiary undertakings		207	293
Fees and commission income		17	22
Fees and commission expense		(8)	(7)
Net trading income or expense		2	(1)
Other operating income		15	10
Net operating income (all from continuing operations)		369	457
Administrative expenses	1	(149)	(138)
Depreciation and amortisation			
Property and equipment	13	(9)	(9)
Operating lease assets	14	(1)	(1)
Intangible assets other than goodwill	12		(1)
Operating expenses		(159)	(149)
Impairment losses on loans and advances	8	(62)	(59)
Operating profit (all from continuing operations)		148	249
Non-operating income	3		20
Profit before taxation		148	269
Tax credit on profit	5	7	12
Profit after taxation		155	281
Attributable to			
Shareholders		155	281

The statement of accounting policies on pages 22 to 25 and the notes on pages 30 to 50 form part of these accounts

Balance Sheet

As at 31 December 2006

	Notes	31 December 2006 £ million	31 December 2005 £ million
Assets			
Derivative assets	6	8	8
Loans and advances to banks		1,995	1,044
Loans and advances to customers	7	19,114	18 874
Investment securities	9	7	7
Interests in jointly controlled entities	10	5	5
Interests in subsidiary undertakings	11	50	50
Property and equipment	13	49	50
Operating lease assets	14	5	7
Current tax assets		34	14
Other assets		86	93
Deferred tax assets	15		10
Prepayments and accrued income		17	17
Total assets		21,370	20,179
Liabilities			
Deposits by banks		19,848	18,473
Customer accounts		6	33
Derivative liabilities	6	16	17
Deferred tax liabilities	15	1	
Other liabilities	16	4	5
Accruals and deferred income		205	264
Other provisions		1	1
Other borrowed funds	17	724	779
Total liabilities		20,805	19,572
Shareholders' equity			
Issued share capital	18	70	70
Share premium		3	3
Retained earnings		492	534
Shareholders' equity	19	565	607
Total liabilities and shareholders equity		21,370	20,179

Approved by the Board on 23rd February 2007 and signed on its behalf by

P J Cummings J Coyle

The statement of accounting policies on pages 22 to 25 and the notes on pages 30 to 50 form part of these accounts

Statement of Recognised Income and Expense

For the year ended 31 December 2006

	31 December 2006	31 December 2005
	£ million	£ million
Profit after taxation	155	281
Total recognised income and expense	155	281
Attributable to		
Shareholders	155	281

The statement of accounting policies on pages 22 to 25 and the notes on pages 30 to 50 form part of these accounts

Cash Flow Statement

For the year ended 31 December 2006

	31 December 2006 £ million	31 December 2005 £ million
Profit before tax	148	269
Adjustments for		
Impairment losses on loans and advances	62	59
Depreciation and amortisation	10	10
Interest on other borrowed funds	33	36
Other non-cash items	(1)	2
Net change in operating assets and liabilities	1,231	167
Net cash flows from operating activities before tax	1,483	543
Income taxes paid	0	(11)
Cash flows from operating activities	1,483	532
Cash flows from investing activities		(3)
Cash flows from financing activities	(288)	(306)
Net increase in cash and cash equivalents	1,195	223
Opening cash and cash equivalents	660	437
Closing cash and cash equivalents	1,855	660

Analysis of cash and cash equivalents

	31 December 2006 £ million	31 December 2005 £ million
Cash and balances at central banks		
Loans and advances to other banks – repayable in less than 3 months	1,855	660
Closing cash and cash equivalents	1,855	660

Investing activities	31 December 2006 £ million	31 December 2005 £ million
Sale of operating lease assets	(1)	
Purchase of property and equipment	(9)	
Sale of property and equipment	10	(3)
Cash flows from investment activities		(3)

Financing activities	31 December 2006 £ million	31 December 2005 £ million
Equity dividends paid	(200)	(270)
Interest on other borrowed funds relating to servicing of finance	(33)	(36)
Repayment of subordinated loan capital	(55)	
Cash flows from financing activities	(288)	(306)

The statement of accounting policies on pages 22 to 25 and the notes on pages 30 to 50 form part of these accounts

Notes to the Accounts

1. 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

	2006 Number	2005 Number
Full time	2,993	3,109
Part time	631	634
	3,624	3,743

No Directors received emoluments for qualifying services to CAPITAL BANK plc in the year ended 31 December 2006

	2006 £ million	2005 £ million
Administrative costs include		
Staff costs	73	80
Accommodation, repairs and maintenance	9	8
Technology	5	5
Marketing and communication	26	31

2. Auditors' remuneration

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

	2006 £ 000	2005 £ 000
Audit services	48	48
Total audit services	48	48

Amounts paid to the Company's auditor in respect of services to the Company, other than the audit of the Company's financial statements, have not been disclosed as the information is required instead to be disclosed on a consolidated basis

3. Non-operating income

Non operating income in 2005 of £20m comprises the profit on sale of fixed asset investments

4. Post retirement benefits

The company is a participating employer in both a defined contribution pension scheme and a defined benefit pension scheme based upon final pensionable pay, operated by HBOS plc

The defined benefit scheme is the HBOS Final Salary Pension Scheme ('HBOS FSPS'), which was formed on 3 July 2006 following the merger of the Bank of Scotland 1976 Pension Scheme, in which the company was previously a participating employer, with three other schemes in the HBOS Group

As there are many companies in the HBOS Group that participate in the HBOS FSPS, the company is unable to identify its share of the scheme assets and liabilities on a consistent and reasonable basis and the HBOS FSPS has been accounted for, in these accounts, as if the scheme was a defined contribution scheme Full details of the HBOS FSPS are available in the accounts of HBOS plc The current deficit net of deferred taxation on the HBOS FSPS at 31 December 2006, valued on an IAS 19 basis by a qualified independent actuary, is £545m (Bank of Scotland 1976 Pension Scheme – 2005 deficit £814m (after DT £570m))

Notes to the Accounts (Continued)

4. Post retirement benefits (continued)

The latest full actuarial valuation of the Bank of Scotland 1976 Pension Scheme was carried out at 31 December 2004 and a full actuarial valuation of the HBOS FSPS is being carried out as at 31 December 2006

The pension expense for the year represents contributions payable by the company to both types of pension scheme and amounted to £1 million (2005 £ nil) for the defined contribution scheme and £10 million (2005 £10 million) for the defined benefit scheme There were no outstanding or prepaid contributions at either the beginning or end of the financial year

Notes to the Accounts (Continued)

5. Taxation

	2006 £ million	2005 £ million
Current tax- Corporation tax credit at 30 per cent (2005 – 30 per cent)	20	10
Deferred taxation (note 15)	(13)	2
Total income tax on profit	7	12
The above tax credit is made up as follows		
Tax on shareholder returns	7	12

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

	2006 £ million	2005 £ million
Profit before taxation	148	269
Profit multiplied by the standard rate of corporation tax in the UK of 30% (2005 30%)	(44)	(81)
Effects of		
Income / expenses not taxable / deductible for tax purposes	57	86
Book gains covered by capital losses/ indexation		6
Amounts written off fixed asset investments		(1)
Adjustments in respect of previous periods	(6)	2
Total income tax on profit	7	12

6. 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 2006 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

Notes to the Accounts (Continued)

6 Derivatives (continued)

2006	Notional Principal Amount	Year End Fair Value Asset	Year End Fair Value Liability
	£ million	£ million	£ million
Derivatives held for trading			
Exchange rate related contracts			
Forward rate agreements	13	1	
Cross currency swaps	28	1	
Equity/index and commodity related contracts			
Options and swaps	1,094		10
Total derivatives held for trading	1,135	2	10
Derivatives held for hedging			
Derivatives designated as cash flow hedges			
Forward rate agreements	346	6	6
Total derivatives held for hedging	346	6	6
Total derivatives	1,481	8	16

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

Notes to the Accounts (Continued)

7. Loans and advances to customers

	2006	2005
	£ million	£million
Gross loans and advances to customers	19,243	19,024
Impairment losses on loans and advances to customers (note 8)	(129)	(150)
Net loans and advances to customers	19,114	18 874

Included in the above are loans to

Subsidiary undertakings £ 11,647million

Jointly controlled entities £ 2,637million

At 31 December 2006 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 22

A maturity analysis of loans and advances to customers is shown in Note 27

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

	2006	2005
	£ million	£ million
Agriculture, forestry and fishing	68	137
Manufacturing industry	139	223
Construction and property	189	246
Hotels, restaurants and wholesale and retail trade	415	425
Transport, storage and communication	142	302
Financial	14,392	14,094
Other services	614	612
Other personal lending	3,114	2,824
Overseas residents	170	161
	19,243	19,024

Notes to the Accounts (Continued)

7 Loans and advances to customers (continued)

Loans and advances to customers include finance leases of £3,477 million (2005 £3,617 million) analysed as follows

	2006 £ million	2005 £ million
Gross investment in finance receivables		
Within one year	1,916	1,964
Between one and five years	1,972	2,079
More than five years	84	92
	3,972	4,135
Less unearned finance income	(495)	(518)
Present value of minimum lease payments	3,477	3,617
Analysed as		
Within one year	1,683	1,720
Between one and five years	1,720	1,816
More than five years	74	81
Finance lease receivables	3,477	3,617

At 31 December 2006 the impairment provision relating to minimum lease payments receivable amounted to £34m (2005 £29m)

8. Impairment losses on loans and advances

	2006 £ million	2005 £ million
At 1 January 2006	150	167
New impairment provisions less releases	72	66
Amounts written off	(89)	(79)
Discount unwind on impaired loans and advances to customers	(4)	(4)
Cumulative provisions as at 31 December 2006	129	150
New impairment provisions less releases	72	66
Recoveries of amounts previously written off	(10)	(7)
Net charge to income statement	62	59

Notes to the Accounts (Continued)

9. Investment securities

	2006		2005	
	Loans and receivables	Total	Loans and receivables	Total
	£ million	£ million	£ million	£ million
Investment securities				
Unlisted debt securities	7	7	7	7
Total investment securities	7	7	7	7

10. Interests in jointly controlled entities

	2006	2005
	Book	Book
	Value	Value
Interests in jointly controlled entities	£ million	£ million
At 1 January 2006 and 31 December 2006	5	5

All the interests in jointly controlled entities are unlisted

	Nature of Business	Issued Share 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 2006	UK
Britannia Personal Lending Limited	Finance	ordinary	£51,000	51%	December 2006	UK
NFU Mutual Finance Limited	Finance	ordinary	£250,002	50%	December 2006	UK
RFS Limited	Finance	ordinary	£3,000,004	50%	December 2006	UK
Corporate Aircraft Leasing Limited	Leasing	ordinary	£500 000	50%	December 2006	UK
Renault Truck Contracts Limited	Finance	ordinary	£250,000	50%	December 2006	UK
Cartwright Limited	Finance	ordinary	£25,000	50%	December 2006	UK

Notes to the Accounts (Continued)

11. Interests in subsidiary undertakings

	2006 Total £ million	2005 Total £ million
At cost at 1 January 2006 and 31 December 2006	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 (February 2006)	100%	Leasing	UK
British Linen Leasing Limited (February 2006)	100%	Leasing	UK
Bank of Scotland Equipment Finance Limited	100%	Leasing	UK
British Linen Shipping Limited (February 2006)	100%	Leasing	UK
Capital Bank Cashflow Finance Limited	100%	Debt Factoring	UK
Capital Bank Leasing 1 Limited (January 2006)	100%	Leasing	UK
Capital Bank Leasing 2 Limited (February 2006)	100%	Leasing	UK
Capital Bank Leasing 3 Limited (March 2006)	100%	Leasing	UK
Capital Bank Leasing 4 Limited (April 2006)	100%	Leasing	UK
Capital Bank Leasing 5 Limited (May 2006)	100%	Leasing	UK
Capital Bank Leasing 6 Limited (June 2006)	100%	Leasing	UK
Capital Bank Leasing 7 Limited (July 2006)	100%	Leasing	UK
Capital Bank Leasing 8 Limited (August 2006)	100%	Leasing	UK
Capital Bank Leasing 9 Limited (September 2006)	100%	Leasing	UK
Capital Bank Leasing 10 Limited (October 2006)	100%	Leasing	UK
Capital Bank Leasing 11 Limited (November 2006)	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

All subsidiary undertakings above have a conterminous year end with CAPITAL BANK plc other than those noted above

Notes to the Accounts (Continued)

12. Other intangible assets

	2006 Software £ million	2006 Total £ million	2005 Software £ million	2005 Total £ million
Cost				
At 1 January 2006	4	4	4	4
At 31 December 2006	4	4	4	4
Amortisation				
At 1 January 2006	4	4	3	3
Amortisation charge in year			1	1
At 31 December 2006	4	4	4	4
Carrying value at 31 December 2006				

Notes to the Accounts (Continued)

13. Property and equipment

	2006 Property £ million	2006 Equipment £ million	2006 Total £ million
Cost			
At 1 January 2006	51	74	125
Intercompany transfer	6	7	13
Additions	1	1	2
Disposals		(2)	(2)
At 31 December 2006	58	80	138
Depreciation			
At 1 January 2006	18	57	75
Depreciation for year	2	7	9
Depreciation on disposals		(2)	(2)
Intercompany transfer	2	5	7
At 31 December 2006	22	67	89
Carrying value at 31 December 2006	36	13	49

	2005 Property £ million	2005 Equipment £ million	2005 Total £ million
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

Notes to the Accounts (Continued)

14 Operating lease assets

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

	2006 Cost £ million	2006 Depreciation £ million	2006 Carrying Value £ million
At 1 January 2006	9	(2)	7
Additions / Disposals	(1)		(1)
Depreciation charge for the year		(1)	(1)
At 31 December 2006	8	(3)	5

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

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

	2006 £ million	2005 £ million
1 year or less		1
Later than 1 year and not later than five years	5	8
	5	9

Notes to the Accounts (Continued)

15. Deferred tax

	2006 £ million	2005 £ million
Deferred tax liabilities	(21)	(11)
Deferred tax assets	20	21
Net position	(1)	10

	2006 £ million	2005 £ million
At 1 January 2006	10	8
Charge to income for the year (note 5)	(13)	2
Charges to equity	2	
At 31 December 2006	(1)	10

Analysed as follows

Deferred tax liabilities	Other £ million	Capital Allowances £ million	2006 Total £ million
At 1 January 2006		(11)	(11)
Charge to income for the year	(13)	1	(12)
Other movement	2		2
At 31 December 2006	(11)	(10)	(21)

Deferred tax assets	Provisions £ million	Other £ million	2006 Total £ million
At 1 January 2006	16	5	21
Charge to income for the year	2	(3)	(1)
Charges to equity		2	2
Other movements		(2)	(2)
At 31 December 2006	18	2	20

16. Other liabilities

	2006 £ million	2005 £ million
Other liabilities	4	5

Notes to the Accounts (Continued)

17. Other borrowed funds

	2006 £ million	2005 £ million
Preference shares	136	136
Subordinated liabilities		
Dated	423	478
Undated	165	165
Total	724	779

Preference shares

	2006 £ million	2005 £ million
9 3/8% Non-cumulative Irredeemable Preference shares	136	136

Subordinated liabilities

	2006 £ million	2005 £ 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
£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
	423	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 (2005 440 million) ordinary shares of 25p each

	Ordinary Stock 25p each £ million	Total £ million
Issued, allotted, called up and fully paid		
At 1 January 2006 and 31 December 2006	70	70
At 1 January 2006 and 31 December 2006	70	70

19. Reconciliation of shareholders equity

2006	Issued share capital £ million	Share premium £ million	Retained earnings £ million	Total £ million
At 1 January 2006	70	3	534	607
Profit after tax			155	155
Cumulative total recognised income and expense	70	3	689	762
Equity element of share plan tax deductions			3	3
Dividends paid in 2006			(200)	(200)
At 31 December 2006	70	3	492	565

2005	Issued share capital £ million	Share premium £ million	Retained earnings £ million	Total £ million
At 1 January 2005	70	3	523	596
Profit after tax			281	281
Cumulative total recognised income and expense	70	3	804	877
Dividends paid in 2005			(270)	(270)
At 31 December 2005	70	3	534	607

Notes to the Accounts (Continued)

20. Dividends

	2006 £ million	2005 £ million
Final ordinary dividend 2004		120
Interim dividend	200	150
	200	270

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

	2006 £ million	2005 £ million
Commitments		
Up to and including 1 year	316	283
Over 1 year	51	84
	367	367

22. 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

2006	At fair value through income statement		Loans and receivables	
	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million
Assets				
Derivative assets	8	8		
Loans and advances to banks			1,995	1,995
Loans and advances to customers			19,114	19,120
Investment securities			7	7
Other assets			6	6
Total financial assets	8	8	21,122	21,128

Notes to the Accounts (Continued)

22. Fair value of financial instruments (continued)

2006	At fair value through the income statement		At amortised cost	
	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million
Liabilities				
Deposits by banks			19,848	19,848
Customer accounts			6	6
Derivative liabilities	16	16		
Other borrowed funds			724	803
Other liabilities			5	5
Total financial liabilities	16	16	20,583	20,662

2005	At fair value through income statement		Loans and receivables	
	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ million
Assets				
Derivative assets	8	8		
Loans and advances to banks			1,044	1,044
Loans and advances to customers			18,874	19,030
Investment securities			7	7
Other assets			134	134
Total financial assets	8	8	20,059	20,215

2005	At fair value through the income statement		At amortised cost	
	Carrying Amount £ million	Fair Value £ million	Carrying Amount £ million	Fair Value £ 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

Notes to the Accounts (Continued)

23. Effective interest rates

	2006 Yield %	2005 Yield %
Assets		
Loans and advances to customers	6 67%	6 95%
Investment securities	3 75%	3 74%
Liabilities		
Customer accounts	4 35%	3 91%
Other borrowed funds		
Preference shares	9 38%	9 38%
Subordinated liabilities	6 08%	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)

24. Interest rate sensitivity gap

The table below summarises the repricing profiles of the Company's assets and liabilities Additional information on the methodology adopted by the Company is given in the 'Risk Management' report on page 5

As at 31 December 2006

	Up to 1 month £ million	1 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	1,867	16	93	19						1,995
Loans and advances to customers	14,558	593	1,340	1,253	746	346	105	173		19,114
Investment securities								7		7
Other assets									254	254
	16,425	609	1,433	1,272	746	346	105	180	254	21,370
Liabilities										
Deposits by banks	10 782	1,015	2,904	2,374	1,193	797	300	483		19,848
Customer accounts	6									6
Other liabilities									227	227
Other borrowed funds		587						137		724
Shareholders funds									565	565
	10,788	1,602	2,904	2,374	1,193	797	300	620	792	21,370
Total interest rate sensitivity gap	5,637	(993)	(1,471)	(1,102)	(447)	(451)	(195)	(440)	(538)	
Cumulative interest rate sensitivity gap	5 637	4,644	3 173	2,071	1,624	1,173	978	538		

As at 31 December 2005

	Up to 1 month £ million	1 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	652	34	226	132						1,044
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									254	254
	10 058	1 593	3 687	2 630	1,083	431	138	305	254	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	559	(136)	643	75	(169)	(53)	(36)	(243)	(640)	
Cumulative interest rate sensitivity gap	559	423	1 066	1 141	972	919	883	640		

Notes to the Accounts (Continued)

25 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 2006		As at 31 December 2005	
	US$	Total	US$	Total
	£ million	£ million	£ million	£ million
Functional Currency of operation involved				
Sterling	28	28	27	27

The US$ denominated balances receivable are the subject of a currency swap contract

There were no structural currency exposures as at 31 December 2006 (2005 £nil)

26. Assets and liabilities in foreign currencies

	31 December 2006	31 December 2005
	£ million	£ million
The aggregate amounts of assets and liabilities denominated in currencies other than sterling were		
Assets	157	338
Liabilities	179	295

The above figures do not reflect the Company's exposure to foreign exchange, which is significantly lower as it is hedged by currency derivatives

Notes to the Accounts (Continued)

27. 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

	As at 31 December 2006					
	Up to 1 month	1 to 3 months	3 to 12 months	1 Year to 5 years	Over 5 years	Total
	£ million	£ million	£ million	£ million	£ million	£ million
Assets						
Derivative assets	2			1	5	8
Loans and advances to banks	1,839	16	121	19		1,995
Loans and advances to customers	14,971	450	1,971	1,601	121	19,114
Investment securities					7	7
Total financial assets	16,812	466	2,092	1,621	133	21,124
Liabilities						
Deposits by banks	12,249	911	2,418	3,793	477	19,848
Customer accounts	6					6
Derivative liabilities	1	1	3	6	5	16
Other borrowed funds	30		79	248	367	724
Total financial liabilities	12,286	912	2,500	4,047	849	20,594

	As at 31 December 2005					
	Up to 1 month	1 to 3 months	3 to 12 months	1 Year to 5 years	Over 5 years	Total
	£ million	£ million	£ million	£ million	£ million	£ million
Assets						
Derivative assets	1			1	6	8
Loans and advances to banks	626	34	252	132		1 044
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

Notes to the Accounts (Continued)

28. 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 £660 million (2005 - £602 million) Loans and advances to banks comprise balances owed by related parties of £2,015 million (2005 - £1,018 million) and deposits by banks comprise amounts owed to related parties of £19,848 million (2005 - £18,473 million) Disclosed within loans and advances to customers are balances owed to the Company by related parties of £14,284 million (2005 - £13,984 million) During 2006 property and equipment was transferred into CAPITAL BANK plc from Bank of Scotland at net book value £2 million HBOS plc is the employer of the personnel working for the Company and staff and other costs amounting to £78 million were recharged to the Company

29. Transactions with key management personnel

The Directors of the Company are considered to be the key management personnel There were no transactions during 2006 between CAPITAL BANK plc and key management personnel

30. 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

31. 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