Discover Financial Services
Form 10-K
January 26, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended November 30, 2011

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 001-33378

DISCOVER FINANCIAL SERVICES
(Exact name of registrant as specified in its charter)

Delaware	36-2517428
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2500 Lake Cook Road, Riverwoods, Illinois 60015	(224) 405-0900
(Address of principal executive offices, including zip code)	(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes S No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No S

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes S No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes S No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the
best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to
this Form 10-K. S

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No S

The aggregate market value of the common equity held by non-affiliates of the registrant on the last business day of the registrant's most recently
completed second fiscal quarter was approximately $12,889,446,066.

As of January 20, 2012, there were 529,976,499 shares of the registrant's Common Stock, par value $0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its annual stockholders' meeting to be held on April 18, 2012 are incorporated by reference in
Part III of this Form 10-K.

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Annual Report on Form 10-K for the year ended November 30, 2011
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Except as otherwise indicated or unless the context otherwise requires, “Discover Financial Services,” “Discover,” “DFS,” “we,” “us,” “our,” and “the Company” refer to Discover Financial Services and its subsidiaries.

We own or have rights to use the trademarks, trade names and service marks that we use in conjunction with the operation of our business, including, but not limited to: Discover®, PULSE®, Cashback Bonus®, Discover® More® Card, Discover® Motiva℠ Card, Discover® Open Road® Card, Discover® Network and Diners Club International®. All other trademarks, trade names and service marks included in this annual report on Form 10-K are the property of their respective owners.

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Part I.

Item 1. Business

Introduction

Discover Financial Services is a direct banking and payment services company. We are a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act, subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the “Federal Reserve”). We offer credit cards, student loans, personal loans and deposit products through our Discover Bank subsidiary. We had $57.3 billion in loan receivables and $26.2 billion in deposits issued through direct-to-consumer channels and affinity relationships at November 30, 2011. We operate the Discover Network, our credit card payments network; the PULSE network (“PULSE”), our automated teller machine (“ATM”), debit and electronic funds transfer network; and Diners Club International (“Diners Club”), our global payments network.

On December 31, 2010, we acquired The Student Loan Corporation (“SLC”) in a merger transaction for $600 million. We received a purchase price closing adjustment, resulting in a net cash outlay of approximately $401 million for the acquisition. We acquired SLC's ongoing private student loan business and approximately $4.2 billion of private student loans and other assets, along with assuming approximately $3.4 billion of SLC's existing asset-backed securitization debt funding and other liabilities. In addition, on September 30, 2011, we purchased approximately $2.5 billion of additional private student loans from Citibank, N.A. ("Citi") for a purchase price equal to 99% of the outstanding aggregate principal and accrued interest balance of the purchased loans (excluding certain charged-off loans) through the closing date. These portfolio acquisitions were accretive to income for the year ended November 30, 2011. In addition, the SLC acquisition provided us with a developed student loan origination platform, additional school relationships, experienced personnel and SLC's website.

In May 2011, we agreed to acquire substantially all of the operating and related assets of Home Loan Center, Inc., a subsidiary of Tree.com, Inc., for approximately $55.9 million, which will add a residential mortgage lending component to our direct banking business. The acquisition is subject to closing conditions, including regulatory approvals.

Available Information

We make available, free of charge through the investor relations page of our internet site http://www.discoverfinancial.com, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, Forms 3, 4 and 5 filed by or on behalf of directors and executive officers, and any amendments to those documents filed with or furnished to the Securities and Exchange Commission (the "SEC") pursuant to the Securities Exchange Act of 1934. These filings are available as soon as reasonably practicable after they are filed with or furnished to the SEC.

In addition, the following information is available on the investor relations page of our internet site: (i) our Corporate Governance Policies; (ii) our Code of Ethics and Business Conduct; and (iii) the charters of the Audit and Risk, Compensation, and Nominating and Governance Committees of our Board of Directors. These documents are also available in print without charge to any person who requests them by writing or telephoning our principal executive offices: Discover Financial Services, Office of the Corporate Secretary, 2500 Lake Cook Road, Riverwoods, Illinois 60015, U.S.A., telephone number (224) 405-0900.

Operating Model

We manage our business activities in two segments: Direct Banking and Payment Services. Our Direct Banking segment includes Discover card-branded credit cards issued to individuals and small businesses on the Discover Network and other consumer banking products and services, including personal loans, student loans, prepaid cards and other consumer lending and deposit products offered through our Discover Bank subsidiary. Our Payment Services segment includes PULSE, Diners Club and our third-party issuing business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties.

We are principally engaged in providing products and services to customers in the United States, although the royalty and licensee revenue we receive from Diners Club licensees is derived from sources outside of the United States. For

quantitative information concerning our geographic distribution, see Note 6: Loan Receivables to our consolidated financial statements, and for quantitative information concerning our royalty revenue, see Note 16: Other Income and Other Expense.
Below are descriptions of the principal products and services of each of our reportable segments. For additional financial information relating to our business and our operating segments, see Note 24: Segment Disclosures to our consolidated financial statements.

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Direct Banking

Credit Cards

We offer credit cards to consumers and small businesses. Our credit card customers are permitted to “revolve” their balances and repay their obligations over a period of time and at an interest rate set forth in their cardmember agreements, which may be either fixed or variable. The interest that we earn on revolving credit card balances makes up approximately 90% of our total interest income. We also charge customers other fees, including fees for late payments, balance transfer transactions and cash advance transactions. We also offer various products and services in connection with our credit card business, such as Payment Protection, Identity Theft Protection, Wallet Protection, Credit ScoreTracker and other fee-based products.

Our credit card customers' transactions in the U.S. are processed over the Discover Network. Where we have a direct relationship with a merchant, which is the case with respect to our large merchants representing a majority of Discover card sales volume, we receive discount and fee revenue from merchants. Discount and fee revenue is based on pricing that is set forth in contractual agreements with each such merchant and is based on a number of factors including industry practices, special marketing arrangements, competitive pricing levels and merchant size.

Where we do not have a direct relationship with a merchant, we receive acquirer interchange and assessment fees from the merchant acquirer that settles transactions with the merchant. The amount of this fee is based on a standardized schedule and can vary based on the type of merchant or type of card (e.g., consumer or business).

Most of our cards offer the Cashback Bonus rewards program, the costs of which we record as a reduction of discount and interchange revenue. See "Marketing - Rewards/Cashback Bonus" for further discussion of our programs offered.

The following chart shows the Discover card transaction cycle as processed on the Discover Network:

Student Loans

We help students and parents finance education costs at select schools by offering private student loans and related services. Private student loans are intended to supplement any financial aid that may be available through grants, scholarships or under the federal government's Direct Lending Program. Historically, we have offered both federal and private student loans. However, effective July 2010, federal legislation required all federal student loans to be made directly by the federal government, and as of November 30, 2011, our remaining federal student loan portfolio was classified as loans held for sale. In December 2011, we agreed to sell substantially all of our remaining federal student loan portfolio. For more information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Developments."

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We currently have two types of variable rate private student loans: (i) Discover student loans through Discover Bank; and (ii) for a transition period after our acquisition of SLC, CitiAssist® loans, which are originated by Citi, and subsequently purchased by Discover Bank. Our private student loans are marketed through colleges and universities, including schools where Discover or Citi is named a preferred lender. Discover student loans and CitiAssist loans are also marketed online and through direct mail. In addition, CitiAssist loans are marketed through marketing agreements with Citi and its affiliates.

Customers can apply for a Discover student loan by mail, online or by phone, where we have dedicated staff within our Discover call centers to service student loans. Customers can apply for a CitiAssist loan online. As part of the loan approval process, virtually all Discover student loans and CitiAssist loans are certified with the school to ensure students do not take on more private student loans than they need. To ensure proper use of loan funds, the majority of loan disbursements are made directly to schools. Upon graduation, Discover student loan borrowers are generally eligible to receive a graduation reward. Students may redeem their graduation reward as a credit to the balance of their student loan or as a direct deposit to a bank account. To encourage responsible credit management, certain CitiAssist loans are eligible for interest rate reductions after the borrower has made a specified number of on-time payments. Discover student loan and CitiAssist loan borrowers can also take advantage of an interest rate reduction when they enroll in recurring automatic payments.

Personal Loans

Our personal loans are unsecured loans with fixed interest rates, terms and payments. These loans are primarily intended to help customers consolidate existing debt, although they can be used for other reasons. In addition to interest earned on personal loans, we also earn fees from personal loan customers who enroll in our credit protection product. We generally market personal loans to our existing credit card customers through direct mail, statement inserts and email. We also market personal loans to non-Discover customers through direct mail. Customers can submit applications via phone, online or through the mail, and can service their accounts online or by phone.

Deposit Products

We obtain deposits from consumers directly or through affinity relationships (“direct-to-consumer deposits”) and through third-party securities brokerage firms that offer our deposits to their customers (“brokered deposits”). Our deposit products include certificates of deposit, money market accounts, online savings accounts and Individual Retirement Account (“IRA”) certificates of deposit.

We market our direct-to-consumer deposit products to our existing customer base and other prospective customers through the use of internet advertising, print materials and affinity arrangements with third parties. Customers can apply for, fund and service their deposit accounts online or via phone, where we have a dedicated staff within our call centers to service deposit accounts. For more information regarding our deposit products, see “Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Funding Sources - Deposits.”

Payment Services

PULSE Network

Our PULSE network is one of the nation’s leading ATM/debit networks. PULSE links cardholders of more than 6,300 financial institutions with ATMs and point-of-sale (“POS”) terminals located throughout the United States. This includes 4,300 financial institutions with which PULSE has direct relationships and more than 2,000 additional financial institutions through agreements PULSE has with other debit networks. PULSE also provides cash access at more than 800,000 ATMs in 100 countries.

PULSE's primary source of revenue is transaction fees charged for switching and settling ATM, personal identification number ("PIN") POS debit and signature debit transactions initiated through the use of debit cards issued by participating financial institutions. In addition, PULSE offers a variety of optional products and services that produce income for the network, including signature debit processing, prepaid card processing, and connections to other regional and national electronic funds transfer networks.

When a financial institution joins the PULSE network, debit cards issued by that institution can be used at all of the ATMs and PIN POS debit terminals that participate in the PULSE network, and the PULSE mark can be used on that

institution's debit cards and ATMs. In addition, financial institution participants may sponsor merchants, direct processors and independent sales organizations to participate in the PULSE PIN POS and ATM debit service. A participating financial institution assumes liability for transactions initiated through the use of debit cards issued by that institution, as well as for ensuring compliance with PULSE's operating rules and policies applicable to that institution's debit cards, ATMs and, if applicable, sponsored merchants, direct processors and independent sales organizations.

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When PULSE enters into a network-to-network agreement with another debit network, the other network's participating financial institutions' debit cards can be used at terminals in the PULSE network. PULSE does not have a direct relationship with these financial institutions and the other network bears the financial responsibility for transactions of those financial institutions' cardholders and for ensuring compliance with PULSE's operating rules.

Diners Club

Our Diners Club business maintains an acceptance network in over 185 countries and territories through its relationships with over 80 licensees, which are generally financial institutions. We do not directly issue Diners Club credit cards to consumers, but grant our licensees the right to issue Diners Club branded credit cards and/or provide card acceptance services. Our licensees pay us royalties for the right to use the Diners Club brand, which is our primary source of Diners Club revenues. We also earn revenue from providing various support services to our Diners Club licensees, including processing and settlement of cross border transactions. We also provide a centralized service center and internet services to our licensees.

When Diners Club cardholders use their cards outside the host country or territory of the issuing licensee, transactions are routed and settled over the Diners Club network through its centralized service center. In order to increase merchant acceptance in certain targeted countries and territories, we are working with merchant acquirers to offer Diners Club and Discover acceptance to their merchants. These acquirers are granted licenses to market the Diners Club brands to existing and new merchants. As we continue to work toward achieving full card acceptance across our networks, Discover customers have begun to use their cards at an increasing number of merchant and ATM locations that accept Diners Club cards around the world. Diners Club cardholders with cards issued by licensees outside of North America are now able to use their cards on the Discover Network in North America and on the PULSE network domestically and internationally.

Third-Party Issuing Business

We have agreements related to issuing credit, debit and prepaid cards with a number of other financial institutions for issuance of card products on the Discover Network. We refer to these financial institutions as "third-party issuers." We earn merchant discount and acquirer interchange revenue, net of issuer interchange paid, plus assessments and fees for processing transactions for third-party issuers of signature cards on the Discover Network.

The following chart shows the third-party issuer transaction cycle:

The discussion below provides additional detail concerning the supporting functions of our two segments. The credit card, student loan, personal loan and deposit products issued through our Direct Banking segment require significant investments in credit risk management, marketing, customer service and technology, whereas the operation of the Discover

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Network and our Payment Services business requires that we invest in technology as well as relationships with issuers, merchants and merchant acquirers.

Credit Risk Management

Credit risk management is a critical component of our management and growth strategy. Credit risk refers to the risk of loss arising from borrower default when borrowers are unable or unwilling to meet their financial obligations to us. Our credit risk is generally highly diversified across millions of accounts without significant individual exposures. We manage risk primarily according to customer segments and product types. See "- Risk Management" for more information regarding how we define and manage our credit and other risks.

Account Acquisition (New Customers)

We acquire new credit card customers through our marketing efforts, including direct mail, internet, media advertising and merchant relationships, or through unsolicited individual applications. We also use targeted marketing efforts to prospective student loan and personal loan customers, although student loan customers may also submit unsolicited individual applications. In all cases, we believe that we have a rigorous process for screening applicants.

To identify credit-worthy prospective customers, our credit risk management team uses proprietary targeting and analytical models and our marketing team matches them with our product offerings. We consider the prospective customer's financial stability, as well as ability and willingness to pay. In order to make the best use of our resources to acquire new accounts, we seek production efficiencies, conduct creative testing and aim to continuously improve our product offerings and enhance our targeting and analytical models.

We assess the creditworthiness of each consumer loan applicant through our underwriting process. We evaluate prospective customers' applications using credit information provided by the credit bureaus and other sources. We use credit scoring systems, both externally developed and proprietary, to evaluate consumer and credit bureau data. When appropriate, we also use experienced credit underwriters to supplement our automated decision-making processes.

Upon approval of a customer's application, we assign a specific annual percentage rate ("APR") using an analytical pricing strategy that provides competitive pricing for customers and seeks to maximize revenue on a risk-adjusted basis. For our credit card loans, we also assign a revolving credit line based on risk level and income.

Portfolio Management (Existing Customers)

The revolving nature of our credit card loans requires that we regularly assess the credit risk exposure of such accounts. This assessment reflects information relating to the performance of the individual's Discover account as well as information from credit bureaus relating to the customer's broader credit performance. We utilize statistical evaluation models to support the measurement and management of credit risk. At the individual customer level, we use custom risk models together with generic industry models as an integral part of the credit decision-making process. Depending on the duration of the customer's account, risk profile and other performance metrics, the account may be subject to a range of account management treatments, including limits on transaction authorization and increases or decreases in purchase and cash credit limits. Our installment loans are billed according to an amortization schedule that is fixed at the time of the disbursement of the loan.

Customer Assistance

We provide our customers with a variety of tools to proactively manage their accounts, including electronic payment reminders and a website dedicated to customer education, as further discussed under the heading "-Customer Service." These tools are designed to limit a customer's risk of becoming delinquent. When a customer's account becomes delinquent or is at risk of becoming delinquent, we employ a variety of strategies to assist customers in becoming current on their accounts.

All monthly billing statements of accounts with past due amounts include a request for payment of such amounts. Customer assistance personnel generally initiate contact with customers within 30 days after any portion of their balance becomes past due. The nature and the timing of the initial contact, typically a personal call or letter, are determined by a review of the customer's prior account activity and payment habits.

We re-evaluate our collection efforts and consider the implementation of other techniques, including internal collection activities and use of external vendors, as a customer becomes increasingly delinquent. We limit our exposure to delinquencies through controls within our process for authorizing transactions and credit limits and criteria-based account suspension and revocation. In situations involving customers with financial difficulties, we may

enter into arrangements to extend or otherwise change payment schedules, lower interest rates and/or waive fees to aid customers in becoming current on their obligations to us.

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Marketing

In addition to working with our credit risk management personnel on account acquisition and portfolio management, our marketing group provides other key functions, including product development, management of our Cashback Bonus and other rewards programs, fee product management, and brand and advertising management.

Product Development

In order to attract and retain customers and merchants, we continue to develop new programs, features, and benefits and market them through a variety of channels, including mail, phone and online. Targeted marketing efforts may include balance transfer offers, fee product offers and reinforcement of our Cashback Bonus and other rewards programs. Through the development of a large prospect database, use of credit bureau data and use of a customer contact strategy and management system, we have been able to improve our modeling and customer engagement capabilities, which helps optimize product, pricing and channel selection.

Rewards / Cashback Bonus

Under our Cashback Bonus program, we provide our credit card customers with up to 1% Cashback Bonus, based upon their spending level and type of purchases. Customers earn 0.25% on their first $3,000 in annual purchases and 1% once their total annual purchases exceed $3,000. Warehouse purchases (those made at select warehouse clubs, wholesale distributors, discount stores and their affiliates) earn 0.25%.

Customers can choose from several card products that allow them to earn their rewards based on how they want to use credit, as set forth below.

- Discover More card offers 5% Cashback Bonus on purchases up to a specified amount, subject to certain limitations, in large retail categories such as gasoline, restaurants and department stores that change throughout the year, and up to 1% unlimited Cashback Bonus on all other purchases.
- Discover Motiva card provides customers with Cashback Bonus for making on-time payments and up to 1% unlimited Cashback Bonus on all purchases.
- Miles by Discover customers receive two miles for every $1 on the first $3,000 in travel and restaurant purchases each year and one mile for every $1 on all other purchases.
- Escape by Discover customers earn two miles for every $1 on all purchases. This card has a $60 annual fee.
- Discover Open Road card customers can earn 2% Cashback Bonus on the first $250 in gas and restaurant purchases each billing period and up to 1% Cashback Bonus on all other purchases.
- Discover Business card offers 5% Cashback Bonus on the first $2,000 in office supply purchases, 2% Cashback Bonus on the first $2,000 in gas purchases each year and up to 1% unlimited Cashback Bonus on all other purchases.

Cardmembers can earn 5-20% Cashback Bonus at over 200 top online retailers when they shop directly through our online shopping portal. Miles by Discover customers earn double miles for their purchases through our online shopping portal. Customers who are not delinquent or otherwise disqualified may pay with Cashback Bonus at select online retailers in any amount. They can redeem their Cashback Bonus in any dollar amount for (i) brand-name merchandise with free shipping at point-of-sale at select merchants such as Amazon, (ii) merchant partner gift cards (starting at $20) that turn their Cashback Bonus into larger rewards, (iii) Discover gift cards or (iv) charitable donations to select charities. For customers who prefer cash, Cashback Bonus can be redeemed starting at and in increments of $50 in the form of a statement credit or direct deposit to a bank account.

Miles by Discover customers who are not delinquent or otherwise disqualified may pay with miles at select online retailers in any amount. Miles can also be redeemed for brand-name merchandise with free shipping at point-of-sale at select merchants such as Amazon, travel credits starting at 10,000 miles, partner gift cards starting at 1,000 miles, Discover gift cards starting at 5,000 miles, cash in the form of statement credits or direct deposit to a bank account starting at 5,000 miles or charitable donations starting at 5,000 miles.

Fee Products

We market several fee-based products to our credit card customers, including the following:

- Identity Theft Protection. The most comprehensive identity theft monitoring product we offer includes an initial credit report, credit bureau report monitoring, prompt alerts that help customers spot possible identity theft quickly, identity theft insurance up to $25,000 to cover certain out-of-pocket expenses due to identity theft, and access to knowledgeable professionals who can provide information about identity theft issues.

- Payment Protection. This product allows customers to suspend their payments for up to two years, depending on the product, in the event of certain covered events. Different products cover different events, such as unemployment,

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disability, natural disasters or other life events, such as marriage or birth of a child. Depending on the product and availability under state laws, outstanding balances up to certain amounts are cancelled in the event of death. A similar product is also offered to our personal loan customers upon request.

- Wallet Protection. This product offers one-call convenience if a customer's wallet is lost or stolen, including requesting cancellation and replacement of the customer's credit and debit cards, monitoring the customer's credit bureau reports for 90 days, providing up to $100 to replace the customer's wallet and, if needed, giving the customer up to a $1,000 cash advance on his or her Discover card account.
- Credit ScoreTracker. This product offers customers resources that help them understand and monitor their credit scores. Credit ScoreTracker is specifically designed for score monitoring by alerting customers when their score changes, allowing customers to set a target score and providing resources to help customers understand the factors that may be influencing their scores.
- Extended Warranties. Discover customers can purchase online service warranties from our extended warranty provider to protect purchases of new electronics and appliances as well as certain other purchases.

Brand and Advertising Management

We maintain a full-service, in-house direct marketing department charged with delivering integrated communications to foster customer engagement with our products and services in addition to supervising external agencies. Our brand team utilizes consumer insights to define our mass communication strategy, create multi-channel advertising messages and develop marketing partnerships with sponsorship properties.

Customer Service

Our customers can contact our customer service personnel by calling 1-800-Discover. Credit card customers also can manage their accounts online or through applications for certain mobile devices. Our internet and mobile solutions offer a range of benefits, including:

- Online account services that allow customers to customize their accounts, choose how and when they pay their bills, create annual account summaries that assist them with budgeting and taxes, research transaction details, initiate transaction disputes, and chat with or email a customer representative;
- Email and mobile text reminders to help customers avoid fees and track big purchases or returns;
- Money management tools like the Spend Analyzer, Paydown Planner and Purchase Planner;
- Secure online account numbers that let customers shop online without ever revealing their actual account numbers; and
- An online portal where customers automatically earn 5-20% Cashback Bonus when they shop at well-known online merchants using their Discover card.

Our personal and student loan customers can utilize our online account services to manage their accounts. Our student loan website also includes interactive tools that provide customers with advice on paying for college and calculators to help them utilize student loans responsibly.

Processing Services

Processing services cover four functional areas: card personalization/embossing, print/mail, remittance processing and document processing. Card personalization/embossing is responsible for the embossing and mailing of plastic credit cards for new accounts, replacements and reissues, as well as gift cards. Print/mail specializes in statement and letter printing and mailing for merchants and customers. Remittance processing, currently a function outsourced to a third-party vendor, handles account payments and check processing. Document processing handles hard-copy forms, including product enrollments and new account applications.

Fraud Prevention

We monitor our customers' accounts to prevent, detect, investigate and resolve fraud. Our fraud prevention processes are designed to protect the security of cards, applications and accounts in a manner consistent with our customers' needs to easily acquire and use our products. Prevention systems handle the authorization of application information, verification of customer identity, sales, processing of convenience and balance transfer checks, and electronic transactions.

Each credit card transaction is subject to screening, authorization and approval through a proprietary POS decision system. We use a variety of techniques that help identify and halt fraudulent transactions, including adaptive models,

rules-based decision-making logic, report analysis, data integrity checks and manual account reviews. We manage accounts identified by the fraud detection system through technology that integrates fraud prevention and customer service. Strategies are subject

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to regular review and enhancement to enable us to respond quickly to changing credit conditions as well as to protect our customers and our business from emerging fraud activity.

Discover Card Terms and Conditions

The terms and conditions governing our credit card products vary by product and change over time. Each credit card customer enters into a cardmember agreement governing the terms and conditions of the customer's account. Discover card's terms and conditions are generally uniform from state to state. The cardmember agreement permits us, to the extent permitted by law, to change any term of the cardmember agreement, including any finance charge, rate or fee, or add or delete any term of the cardmember agreement, with notice to the customer as required by law. The customer has the right to opt out of certain changes of terms and pay their balance off under the unchanged terms. Each cardmember agreement provides that the account can be used for purchases, cash advances and balance transfers.

Each Discover card account is assigned a credit limit when the account is initially opened. Thereafter, individual credit limits may be increased or decreased from time to time, at our discretion, based primarily on our evaluation of the customer's creditworthiness. We offer various features and services with the Discover card accounts, including the Cashback Bonus rewards programs described under " - Marketing - Rewards/Cashback Bonus."

All Discover card accounts generally have the same billing structure, though there are some differences between the consumer and business credit cards. We generally send a monthly billing statement to each customer who has an outstanding debit or credit balance. Customers also can waive their right to receive a physical copy of their bill, in which case they will receive email notifications of the availability of their billing statement online. Discover card accounts are grouped into multiple billing cycles for operational purposes. Each billing cycle has a separate billing date, on which we process and bill to customers all activity that occurred in the related accounts during a period of approximately 28 to 32 days that ends on the billing date.

Discover card accounts are assessed periodic finance charges using fixed and/or variable interest rates. Certain account balances, such as balance transfers, may accrue periodic finance charges at lower fixed rates for a specified period of time. Variable rates are indexed to the highest prime rate published in The Wall Street Journal on the last business day of the month. Periodic finance charges are calculated using the daily balance (including current transactions) method, which results in daily compounding of periodic finance charges, subject to a grace period on new purchases. The grace period essentially provides that periodic finance changes are not imposed on new purchases, or any portion of a new purchase, that is paid by the due date on the customer's current billing statement if the customer paid the balance on their previous billing statement in full by the due date on that statement. Neither cash advances nor balance transfers are subject to a grace period.

Each consumer with an outstanding debit balance on his or her Discover card account must generally make a minimum payment each month. If a customer exceeds his or her credit limit as of the last day of the billing period, we may include all or a portion of this excess amount in the customer's minimum monthly payment. A customer may pay the total amount due at any time. We also may enter into arrangements with delinquent customers to extend or otherwise change payment schedules, and to waive finance charges and/or fees, including re-aging accounts in accordance with regulatory guidance.

In addition to periodic finance charges, we may impose other charges and fees on Discover card accounts, including cash advance transaction fees, late fees where a customer has not made a minimum payment by the required due date, balance transfer fees and returned payment fees. We also charge fees each time we decline to honor a balance transfer check, cash advance check, or other promotional check due to such reasons as insufficient credit availability, delinquency or default.

The Credit Card Accountability Responsibility and Disclosure Act of 2009 required us, beginning February 2011, to review, every six months, certain interest rates that were increased on accounts since January 1, 2009 to determine whether to reduce the interest rate based on the factors that prompted the increase or factors we currently consider in determining interest rates applicable to similar new credit card accounts. The amount of any rate decrease must be determined based upon our reasonable policies and procedures. Any reduced interest rate must be applied to the account not later than 45 days after completion of the review.

Terms and conditions may vary for other products, such as the Discover business card and personal and student loans.

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Discover Network Operations

We support our growing base of merchants through a merchant acquiring model that includes direct relationships with large merchants in the United States and arrangements with merchant acquirers for small- and mid-size merchants. In addition to our U.S.-based merchant acceptance locations, Discover Network cards also are accepted at many locations in Canada, Mexico, the Caribbean, China, Japan and a growing number of countries around the world on the Diners Club network.

We maintain direct relationships with most of our largest merchant accounts, which enables us to benefit from joint marketing programs and opportunities and to retain the entire discount revenue from the merchant. The terms of our direct merchant relationships are governed by merchant services agreements. These agreements also are accompanied by additional program documents that further define our network functionality and requirements, including operating regulations, technical specifications and dispute rules. To enable ongoing improvements in our network's functionality and in accordance with industry convention, we publish updates to our program documents on a semi-annual basis. Discover card transaction volume was concentrated among our top 100 merchants in 2011, with our largest merchant accounting for approximately 8% of that transaction volume.

In order to increase merchant acceptance, Discover Network has sold the majority of its small and mid-size merchant portfolios to third-party merchant acquirers to allow them to offer a comprehensive payments processing package to such merchants. Merchants also can apply to our merchant acquirer partners directly to accept Discover Network cards through the acquirers' integrated payments solutions. Merchant acquirers provide merchants with consolidated servicing for Discover, Visa and MasterCard transactions, resulting in streamlined statements and customer service for our merchants, and reduced costs for us. These acquirer partners also perform credit evaluations and screen applications against unacceptable business types and the Office of Foreign Asset Control Specifically Designated Nationals list.

Discover Network operates systems and processes that seek to prevent fraud and ensure compliance with our operating regulations. Our systems evaluate incoming transaction activity to identify abnormalities that require investigation and fraud mitigation. Designated Discover Network personnel are responsible for validating compliance with our operating regulations and law, including enforcing our data security standards and prohibitions against internet gambling and other illegal or otherwise unacceptable activities. Discover Network is a founding and current member of the Payment Card Industry Security Standards Council, LLC, and generally requires merchants and service providers to comply with the Payment Card Industry Security Standards Council data security standards.

Technology

We provide technology systems processing through a combination of owned and hosted data centers and the use of third-party vendors. These data centers support our payment networks, provide customers with access to their accounts, and manage transaction authorizations, among other functions. Discover Network works with a number of vendors to maintain our connectivity in support of POS authorizations. This connectivity also enables merchants to receive timely payment for their Discover Network card transactions.

Our approach to technology development and management involves both third-party and in-house resources. We use third-party vendors for basic technology services (e.g., telecommunications, hardware and operating systems) as well as for processing and other services for our direct banking and payment services businesses. We subject each vendor to a formal approval process to ensure that the vendor can assist us in maintaining a cost-effective and reliable technology platform. We use our in-house resources to build, maintain and oversee some of our technology systems. We believe this approach enhances our operations and improves cost efficiencies.

Seasonality

In our credit card business, we experience fluctuations in transaction volumes and the level of loan receivables as a result of higher seasonal consumer spending and payment patterns around the winter holidays, summer vacations and back-to-school periods. In our student loan business, our loan disbursements peak at the beginning of a school's academic semester or quarter. Although there is a seasonal impact to transaction volumes and the level of student and credit card loan receivables, seasonal trends have not caused significant fluctuations in our results of operations or credit quality metrics between quarterly and annual periods.

Revenues in our Diners Club business are generally higher in the first half of the year as a result of Diners Club's tiered pricing system where licensees qualify for lower royalty rate tiers as cumulative volume grows during the course of the year.

Competition

We compete with other consumer financial services providers and payment networks on the basis of a number of factors, including brand, reputation, customer service, product offerings, incentives, pricing and other terms. Our credit card business also competes on the basis of reward programs and merchant acceptance. We compete for accounts and utilization with cards issued by other financial institutions (including American Express, Bank of America, Capital One, JPMorgan Chase and Citi) and, to a lesser extent, businesses that issue their own private label cards or otherwise extend credit to their customers. In comparison to our largest credit card competitors, our strengths include cash rewards, conservative portfolio management and strong customer service. Competition based on cash rewards programs, however, has increased in the past year. Our student loan product competes for customers with Sallie Mae, Wells Fargo and JPMorgan Chase, as well as other financial institutions that offer student loans. Our personal loan product competes for customers primarily with JPMorgan Chase, Capital One, Wells Fargo and Citi. Although our student and personal loan receivables have increased, our credit card receivables continue to represent most of our receivables. The credit card business is highly competitive. Some of our competitors offer a wider variety of loan products than we do, including automobile and home loans, which may position them better among customers who prefer to use a single financial institution to meet all of their financial needs. Some of our competitors enjoy greater financial resources, diversification and scale than we do, and are therefore able to invest more in initiatives to attract and retain customers, such as advertising, targeted marketing, account acquisitions and pricing competition in interest rates, annual fees, reward programs and low-priced balance transfer programs. In addition, some of our competitors have assets such as branch locations and co-brand relationships that may help them compete more effectively. Another competitive factor in the credit card business is the increasing use of debit cards as an alternative to credit cards for purchases.

Because most domestically issued credit cards, other than those issued on the American Express network, are issued on the Visa and MasterCard networks, most other card issuers benefit from the dominant market share of Visa and MasterCard. The former exclusionary rules of Visa and MasterCard limited our ability to attract merchants and credit and debit card issuers, contributing to Discover not being as widely accepted in the U.S. as Visa and MasterCard. Merchant acceptance of the Discover card, however, has continued to increase and we are making investments to further grow acceptance both domestically and internationally.

In our payment services business, we compete with other networks for volume and to attract third-party issuers to issue credit, debit and prepaid cards on the Discover, PULSE and Diners Club networks. We generally compete on the basis of customization of services and various pricing strategies, including incentives and rebates. We also compete on the basis of issuer interchange fees, fees paid to networks (including switch fees), merchant acceptance, network functionality, customer perception of service quality, brand image, reputation and market share. The Diners Club and Discover networks' primary competitors are Visa, MasterCard and American Express, and PULSE's network competitors include Visa's Interlink, MasterCard's Maestro and First Data's STAR. American Express is a particularly strong competitor to Diners Club as both cards target international business travelers. As the payments industry continues to evolve, we are also facing increasing competition from new entrants to the market, such as online networks, telecom providers and other providers, that leverage new technologies and a customer's existing deposit and credit card accounts and bank relationships to create payment or other fee-based solutions.

In our direct-to-consumer deposits business, we have acquisition and servicing capabilities similar to other direct competitors, including Nationwide, USAA, Ally Financial, American Express, Capital One Direct, ING Direct and Sallie Mae. We also compete with traditional banks and credit unions that source deposits through branch locations. We seek to differentiate our deposit product offerings on the basis of brand reputation, convenience, customer service, and value.

For more information regarding the nature of and the risks we face in connection with the competitive environment for our products and services, see the following in "Risk Factors:" "We face competition from other consumer financial service providers, and we may not be able to compete effectively, which could result in fewer customers and lower account balances and could materially adversely affect our financial condition, cash flows and results of operations;" "We incur considerable expenses in competing with other consumer financial service providers, and many of our competitors have greater financial resources than we do, which may place us at a competitive

disadvantage and negatively affect our financial results;" "We face competition from other operators of payment networks, and we may not be able to compete effectively, which could result in reduced transaction volume, limited merchant acceptance of our cards, limited issuance of cards on our networks by third parties and materially reduced earnings;" and "An inability to accept or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business."

Intellectual Property

We use a variety of methods, such as trademarks, patents, copyrights and trade secrets, to protect our intellectual property. We also place appropriate restrictions on our proprietary information to control access and prevent unauthorized disclosures. Our Discover, PULSE and Diners Club brands are important assets, and we take steps to protect the value of these assets and our reputation.

Employees

As of January 20, 2012, we employed approximately 11,650 individuals.

Risk Management

The understanding, identification and management of risk are important elements to our success. Accordingly, we maintain a comprehensive risk management program to identify, measure, monitor, evaluate, manage and report on the principal risks we assume in conducting our activities. These risks include credit, market, liquidity, operational, compliance and legal, and strategic risks.

Enterprise Risk Management Principles

Our enterprise risk management philosophy is to ensure that all relevant risks inherent in our business activities are appropriately identified, measured, monitored, evaluated, managed and reported. Our enterprise risk management philosophy is expressed through five key principles that guide our approach to risk management: comprehensiveness, accountability, independence, defined risk appetite and strategic limits, and transparency.

Comprehensiveness. We seek to maintain a comprehensive framework for managing risk enterprise wide, including policies, risk management processes, monitoring, and reporting. Our framework is designed to be comprehensive with respect to our reporting segments and their control and support functions, and it extends across all risk types.

Accountability. We structure accountability along the principles of risk management execution, oversight and independent validation. Our business units hold primary accountability for management of the risks to which their businesses are exposed. Our principles apply across all businesses and risk types.

Independence. We maintain independent risk and control functions including our corporate risk management, law and compliance, and internal audit departments. Our Corporate Risk Officer, who leads our corporate risk management department, is appointed by our Board of Directors and is accountable for providing an independent perspective on the risks to which we are exposed; how well management is identifying, assessing and managing risk; and the capabilities we have to manage risk across the enterprise.

Defined Risk Appetite and Strategic Limits. Our Board of Directors approves a risk appetite and strategic limit framework, which establishes an acceptable level of risk taking, considering desired financial returns and other objectives. To that end, management sets, maintains and enforces policies, as well as limits and escalation triggers, that are consistent with our risk appetite and strategic limits framework.

Transparency. Our risk management framework seeks to provide transparency of exposures and outcomes and is core to our risk culture and operating style. We provide transparency through our risk committee structure, processes for escalating risk incidents, and risk reporting at each level, including quarterly reports to our Risk Committee and the Audit and Risk Committee of our Board of Directors.

Risk Management Roles and Responsibilities

Responsibility for risk management is held at several different levels, including our Board of Directors, the Audit and Risk Committee of our Board of Directors, our Risk Committee, our Chief Executive Officer, our Corporate Risk Officer, our corporate risk management department, our legal and compliance department and our internal audit department.

Board of Directors. Our Board of Directors is responsible for: (i) approval of certain risk management policies, (ii) approval of our risk appetite and strategic limit framework, (iii) oversight of our strategic plan, and (iv) appointment of our Corporate Risk Officer.

Audit and Risk Committee of our Board of Directors. The Audit and Risk Committee of our Board of Directors reviews reports from management on our enterprise-wide risk management program. The Committee also reviews with management the framework for assessing and managing our risk exposures and the steps management has taken to monitor and control such risk exposures. The Committee also reviews reports from management on the status of and changes to risk exposures, policies, procedures and practices.

Risk Committee. Our Risk Committee is a management-level committee, authorized by the Audit and Risk Committee of our Board of Directors and chaired by our Corporate Risk Officer, that provides a forum for our senior management team to review and discuss credit, market, liquidity, operational, legal and compliance, and strategic risks across the company and for

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each business unit. Risk Committee membership consists of all members of the Executive Committee and the Corporate Risk Officer. The Committee regularly reports to the Audit and Risk Committee of our Board of Directors on risks and risk management. Our Risk Committee has formed a number of committees to assist it in carrying out its responsibilities. Each committee is guided by a charter that defines the mandates of the committee in further detail. These committees, made up of representatives from senior levels of management, escalate issues to our Risk Committee as necessary. These risk management committees include the Asset/Liability Management Committee, the Capital Planning Committee, the Counterparty Credit Committee, the Discover Bank Credit Committee, the Discover Bank Pricing Committee, the Payment Services Steering Committee, the New Initiatives Committee, the Operational Risk Committee and the Privacy and Policy Committee.

Chief Executive Officer. Our Chief Executive Officer is ultimately responsible for our risk management. In that capacity, our Chief Executive Officer establishes our risk management culture and ensures the business operates in accordance with our risk culture. Our Corporate Risk Officer reports to our Chief Executive Officer.

Senior Executive Officers. Our senior executive officers are responsible for ensuring their business units operate within established risk limits. They are also responsible for identifying risks; explicitly considering risk when developing strategic plans, budgets and new products; and implementing appropriate risk controls when pursuing business strategies and objectives. Senior executive officers also coordinate with our corporate risk management department to produce relevant, sufficient, accurate and timely risk reporting that is consistent with the processes and methodology established by our corporate risk management department. In addition, our senior executive officers are responsible for ensuring that sufficient financial resources and qualified personnel are deployed to manage the risks inherent in our business activities.

Corporate Risk Officer. Our Corporate Risk Officer chairs our Risk Committee and manages our corporate risk management department. Our Corporate Risk Officer is responsible for establishing and implementing standards for the identification, management and measurement of risk on an enterprise-wide basis, as well as for monitoring and reporting such risks.

Corporate Risk Management. Our corporate risk management department is led by our Corporate Risk Officer and supports business units by providing objective oversight of our risk profile and ensuring risks are managed as defined by policy. Our corporate risk management department also provides risk management tools and policies, and aggregates and reports our risks to our Board of Directors, the Audit and Risk Committee of our Board of Directors and our Risk Committee.

Law and Compliance Department. Our law and compliance department is responsible for establishing and maintaining a compliance program that includes compliance risk identification, assessment, policy development, monitoring, testing, training and reporting activities. Through collaboration with business units, our law and compliance department incorporates a commitment to compliance in our day-to-day activities. Our Chief Compliance Officer reports to our General Counsel.

Internal Audit Department. Our internal audit department is responsible for performing periodic, independent reviews and testing of compliance with our risk management policies and standards, performing assessments of the design and operating effectiveness of these policies and standards, and validating that all risk management controls are functioning as intended. The head of our internal audit department reports to the Audit and Risk Committee of our Board of Directors.

Risk Appetite and Strategic Limit Structure

Our risk appetite and strategic limit structure establishes the amount of risk, on a broad level, that we are willing to accept in pursuit of shareholder value. It reflects our risk management philosophy and, in turn, influences our culture and operating style. Our determination of risk appetite and strategic limits is directly linked to our strategic planning process and is consistent with our aspirations and mission statement. Risk appetite expressions and strategic limits are categorized by risk type, cascade through our committees and business units, and are incorporated into business decisions, reporting and day-to-day business discussions. Our risk appetite expressions and strategic limits also serve as tools to preclude business activities that are inconsistent with our long-term goals. Our risk appetite and strategic limit structure is approved by our Board of Directors.

Management and our corporate risk management department monitor approved limits and escalation triggers to ensure that the business is operating within the expressed risk appetite and strategic limits. Risk limits are monitored and reported on to various risk committees and our Board of Directors, as appropriate. Through ongoing monitoring of risk exposures, management is able to identify appropriate risk response and mitigation strategies in order to react dynamically to changing conditions.

Risk Categories

Our risk management program is organized around six major risk categories: credit risk, market risk, liquidity risk, operational risk, legal and compliance risk, and strategic risk. We evaluate the potential impact of a risk event on the company by assessing the financial impact, the impact to our reputation, the legal and regulatory impact, and the client/customer impact. In addition, we have established various policies to help govern these risks.

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Credit Risk. Credit risk arises from the potential that a borrower or counterparty will fail to perform on an obligation. Our credit risk includes consumer credit risk and counterparty credit risk. Consumer credit risk is primarily incurred by issuing loans to consumers. Counterparty credit risk is incurred through a number of activities including settlement, certain marketing programs, treasury and asset/liability management, network incentive programs, vendor relationships and insurers.

Management of consumer credit risk is the primary responsibility of the Discover Bank Credit Committee. The responsibilities of the Discover Bank Credit Committee include: (i) establishing consumer credit risk philosophy and tolerance; (ii) establishing procedures for implementing and ensuring compliance with risk identification, measurement, monitoring, and management policies and procedures for consumer credit risk management; and (iii) reviewing, on a periodic basis, aggregate risk exposures and efficacy of risk measurement, monitoring and management policies and procedures within the credit risk management department.

Counterparty credit risk is managed through our Counterparty Credit Committee. Our Counterparty Credit Committee's responsibilities include: (i) establishing an enterprise-wide approach to counterparty credit risk management through a program for the identification, measurement, management and reporting of counterparty credit risks; (ii) providing oversight for controls, limits, thresholds and governance processes related to our ongoing management of counterparty credit risks; (iii) reviewing our enterprise-wide portfolio of counterparty risks and ensuring those risks remain within our tolerances; and (iv) approving acceptance of and limits for counterparties that represent significant exposure to us.

Market Risk. Market risk is the risk to our financial condition resulting from adverse movements in market rates or prices, such as interest rates, foreign exchange rates, credit spreads or equity prices. We are exposed to various types of market risk, in particular interest rate risk and other risks that arise through the management of our investment portfolio. Market risk exposures are managed through the Asset/Liability Management Committee. The responsibilities of our Asset/Liability Management Committee include: (i) maintaining oversight and responsibility for all risks associated with the asset/liability management process, including risks associated with liquidity and funding, market risk and our investment portfolio; and (ii) recommending limits to be included in our risk appetite and limit structure.

Liquidity Risk. Liquidity risk is the potential that we will be unable to meet our obligations as they come due because of an inability to obtain adequate funding or liquidate assets without significantly lowering market prices because of inadequate market depth or market disruptions. Liquidity risk exposures are managed through our Asset/Liability Management Committee. The responsibilities of our Asset/Liability Management Committee are described above.

Operational Risk. Operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or external events will result in reputational harm or losses. Operational risk also arises from model risk, which is the potential that we will incur a financial loss, make incorrect business decisions or cause damage to our reputation as a result of: (i) errors in financial and decision model design and development, (ii) misapplication of financial or decision models, or (iii) errors in the financial and decision model production process. We further differentiate operational risk into the following sub-categories: theft and fraud; employment practices and workplace safety; customer, products and business practices; technology; physical asset and data security; processing; financial and reporting; and external provider.

Operational risk exposures are managed through a combination of business line management and enterprise-wide oversight. Enterprise-wide oversight is provided through our Operational Risk Committee. Responsibilities of our Operational Risk Committee include: (i) establishing and communicating operational risk policies, tolerance and philosophy; (ii) establishing procedures for implementing our operational risk measurement, monitoring and management policies; and (iii) reviewing aggregate risk exposures and the efficacy of our risk identification, measurement, monitoring and management policies and procedures, and related controls within our business units. In addition, model risk is managed through a model governance process and models are subject to independent validation.

Compliance and Legal Risk. Compliance risk is the operational risk of legal or regulatory sanctions, financial loss or damage to reputation resulting from failure to comply with laws, regulations, rules, other regulatory requirements, or codes of conduct and other standards of self-regulatory organizations applicable to us. Legal risk arises, in part, from

the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect our operations or condition. These risks are inherent in all of our businesses. Both compliance and legal risk are sub-sets of operational risk but are recognized as a separate and complementary risk category by us given their importance and the specific capabilities and resources we deploy to manage these risk types effectively.

Compliance and legal risk exposures are actively and primarily managed by our business units in conjunction with our law and compliance department. Our compliance program governs the management of compliance risk. Our Risk Committee oversees our compliance and legal risk management. Our law and compliance department provides independent oversight for all of our compliance and legal risk management activities. Our law and compliance department coordinates with our corporate risk management department for the management of compliance and legal risks by reporting and escalating material incidents, completing risk and control self-assessments, and monitoring and reporting key risk indicators.

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Strategic Risk. Strategic risk can arise from adverse business decisions, improper implementation of decisions, unanticipated economic events, failure to anticipate and respond to industry changes (including legislative and regulatory changes), failure to create and maintain a competitive business model, and failure to attract and profitably serve customers. Our Executive Committee actively manages strategic risk through the development, implementation and oversight of our business strategies, including the development of budgets and business plans. Our business units take and are accountable for managing strategic risk in pursuit of their objectives. In addition, the assessment of strategic risk is an important consideration of various sub-committees of our Risk Committee. For example, the strategic and other risks associated with new products or services are reviewed and reported on by our New Initiatives Committee and our Payment Services Steering Committee.
Our corporate risk management department also plays an important role in the management of strategic risk by: (i) overseeing the objective setting and strategic planning processes from a risk perspective, to gain comfort that strategic risks have been adequately considered in the setting of objectives and development of strategies; (ii) providing an independent risk perspective to the new initiatives process; and (iii) assessing if there is effective alignment of management's proposed long-term strategic objectives with the risk appetite and strategic limits approved by our Board of Directors.

Capital Planning

Our capital planning and capital adequacy assessment process is designed to ensure capital adequacy against identified risks. The Capital Planning Committee, which is chaired by the Chief Operating Officer, oversees the development of our strategic capital plans. Our plans are reviewed and approved by our Board of Directors.

Risk Management Review of Compensation

Our employee compensation program is designed to appropriately balance risk and reward without encouraging imprudent risk-taking. Our Corporate Risk Officer leads periodic risk assessments of our compensation plans and reports results to the Compensation Committee of our Board of Directors.

Supervision and Regulation

General

Our operations are subject to extensive regulation, supervision and examination under U.S. federal, state and foreign laws and regulations. As a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act, we are subject to the supervision, examination and regulation of the Federal Reserve. As a large provider of consumer financial services, we are subject to the supervision, examination and regulation of the Consumer Financial Protection Bureau ("CFPB").
We operate two banking subsidiaries, each of which is in the United States. Discover Bank, our main banking subsidiary, offers credit card loans, student loans and personal loans, as well as certificates of deposit, savings accounts and other types of deposit accounts. Discover Bank is chartered and regulated by the Office of the Delaware State Bank Commissioner (the “Delaware Commissioner”), and is also regulated by the Federal Deposit Insurance Corporation (“FDIC”), which insures its deposits up to applicable limits and serves as the bank's primary federal banking regulator. Our other bank, Bank of New Castle, is also chartered and regulated by the Delaware Commissioner and insured and regulated by the FDIC.

Bank Holding Company Regulation

Permissible activities for a bank holding company include those activities that are so closely related to banking as to be a proper incident thereto, such as consumer lending and other activities that have been approved by the Federal Reserve by regulation or order. Certain servicing activities are also permissible for a bank holding company if conducted for or on behalf of the bank holding company or any of its affiliates. Impermissible activities for bank holding companies include activities that are related to commerce such as retail sales of nonfinancial products.
A financial holding company and the non-bank companies under its control are permitted to engage in activities considered financial in nature, incidental to financial activities, or complementary to financial activities, if the Federal Reserve determines that such activities pose no risk to the safety or soundness of depository institutions or the financial system in general.
Being a financial holding company under the Gramm-Leach-Bliley Act requires that the depository institutions that we control meet certain criteria, including capital, management and Community Reinvestment Act requirements. In

addition, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Reform Act”) enacted in July 2010, we are required to meet certain capital and management criteria to maintain our status as a financial holding company. If we or our depository institutions were to fail to continue to meet the criteria for financial holding company status, we could, depending on which requirements we failed to meet, face restrictions on new financial activities or acquisitions and/or be required to discontinue existing activities that are not generally permissible for bank holding companies.

Federal Reserve regulations and the Federal Deposit Insurance Act, as amended by the Reform Act, require that bank holding companies serve as a source of strength to each subsidiary bank and commit resources to support each subsidiary bank.

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This support may be required at times when a bank holding company may not be able to provide such support without adversely affecting its ability to meet other obligations.
The Reform Act addresses risks to the economy and the payments system, especially those posed by large systemically significant financial firms. Bank holding companies with $50 billion or more in total consolidated assets, including Discover, are considered systemically significant under the Reform Act and are subject to heightened prudential standards to be established by the Federal Reserve. The Reform Act could have a significant impact on us by, for example, requiring us to limit or change our business practices, limiting our ability to pursue business opportunities, requiring us to invest valuable management time and resources in compliance efforts, imposing additional costs on us, limiting fees we can charge for services, requiring us to meet more stringent capital, liquidity and leverage ratio requirements (including those under Basel III), impacting the value of our assets, or otherwise adversely affecting our businesses. For more information regarding the Reform Act, see “Management's Discussion and Analysis of Financial Condition and Results of Operations - Regulatory Environment and Developments” and “Risk Factors.”
Capital, Dividends and Share Repurchases
We, Discover Bank and Bank of New Castle are subject to capital adequacy guidelines adopted by federal banking regulators, which include maintaining minimum capital and leverage ratios for capital adequacy and higher ratios to be deemed "well-capitalized." As a bank holding company, we are required to maintain Tier 1 and total capital equal to at least 4% and 8% of our total risk-weighted assets, respectively. We are also required to maintain a minimum “leverage ratio” (Tier 1 capital to adjusted total assets) of 4% to 5%, depending upon criteria defined and assessed by the Federal Reserve. Further, under the Federal Reserve's annual capital plan requirements, we are required to demonstrate that under stress scenarios we will maintain a Tier 1 common ratio (meaning the ratio of Tier 1 common capital to total risk-weighted assets) above 5%. At November 30, 2011, Discover Financial Services met all requirements to be deemed “well-capitalized.” For related information regarding our bank subsidiaries, see "-FDIA" below.
Current or future regulatory initiatives may require us to hold more capital in the future. In December 2011, the Federal Reserve issued proposed rules to implement heightened prudential standards for large bank holding companies, including us, as required by the Reform Act, including risk-based capital and leverage standards. In November 2011, the Federal Reserve issued a final rule requiring the submission of annual capital plans to the Federal Reserve for its review and non-objection. The instructions accompanying the Federal Reserve's final rule regarding capital plans indicate that the Federal Reserve expects covered companies to show that they can achieve “readily and without difficulty the ratios required by the Basel III framework as they would come into effect in the United States.” For more information regarding recent regulatory initiatives, see “- Regulatory Environment and Developments - Capital and Liquidity.”
There are various federal and state law limitations on the extent to which our banking subsidiaries can provide funds to us through dividends, loans or otherwise. These limitations include minimum regulatory capital requirements, federal and state banking law requirements concerning the payment of dividends out of net profits or surplus, and general federal and state regulatory oversight to prevent unsafe or unsound practices. In general, federal and applicable state banking laws prohibit, without first obtaining regulatory approval, insured depository institutions, such as our banking subsidiaries, from making dividend distributions if such distributions are not paid out of available earnings or would cause the institution to fail to meet applicable capital adequacy standards. For more information, see “-FDIA” below.
Additionally, as referred to above, we are required to submit an annual capital plan to the Federal Reserve that includes an assessment of our expected uses and sources of capital over the planning horizon. Our ability to make capital distributions, including our ability to pay dividends or repurchase shares of our common stock, is subject to the Federal Reserve's review and non-objection of our annual capital plan. In certain circumstances, we will not be able to make a capital distribution unless the Federal Reserve has approved such distribution. For additional information regarding capital, dividends and share repurchases, see "Risk Factors - We may be limited in our ability to pay dividends and repurchase our common stock," "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities," “Management's Discussion and Analysis of Financial Condition and Results

of Operations - Regulatory Environment and Developments - Capital and Liquidity," "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Capital" and Note 19: Capital Adequacy to our consolidated financial statements.

FDIA

The Federal Deposit Insurance Act (the "FDIA") imposes various requirements on insured depository institutions. For example, the FDIA requires, among other things, the federal banking agencies to take "prompt corrective action" in respect of depository institutions that do not meet minimum capital requirements. The FDIA sets forth the following five capital tiers: "well-capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors that are established by regulation. At November 30, 2011, Discover Bank and Bank of New Castle met all applicable requirements to be deemed "well-capitalized." As noted above, recently-issued Federal

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Reserve rules and additional future rulemaking, including with respect to implementation of Basel III, could alter the capital adequacy framework for covered banking organizations.

The FDIA also prohibits any depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be "undercapitalized." "Undercapitalized" institutions are subject to growth limitations and are required to submit a capital restoration plan. For a capital restoration plan to be acceptable, among other things, the depository institution's parent holding company must guarantee that the institution will comply with the capital restoration plan.

If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized." "Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

Each of our banking subsidiaries may also be held liable by the FDIC for any loss incurred, or reasonably expected to be incurred, due to the default of the other U.S. banking subsidiary and for any assistance provided by the FDIC to the other U.S. banking subsidiary that is in danger of default.

The FDIA prohibits a bank from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in its normal market area or nationally (depending upon where the deposits are solicited), unless (1) it is "well-capitalized," or it is "adequately capitalized" and receives a waiver from the FDIC. A bank that is "adequately capitalized" and that accepts brokered deposits under a waiver from the FDIC may not pay an interest rate on any deposit in excess of 75 basis points over certain prevailing market rates. There are no such restrictions under the FDIA on a bank that is "well-capitalized." As of November 30, 2011, Discover Bank and Bank of New Castle each met the FDIC's definition of a "well-capitalized" institution for purposes of accepting brokered deposits. An inability to accept brokered deposits in the future could materially adversely impact our funding costs and liquidity. For more information, see "Risk Factors - An inability to accept or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business."

The FDIA also affords FDIC-insured depository institutions, such as Discover Bank and Bank of New Castle, the ability to "export" favorable interest rates permitted under the laws of the state where the bank is located. Discover Bank and Bank of New Castle are both located in Delaware and, therefore, charge interest on loans to out-of-state borrowers at rates permitted under Delaware law, regardless of the usury limitations imposed by the state laws of the borrower's residence. Delaware law does not limit the amount of interest that may be charged on loans of the type offered by Discover Bank or Bank of New Castle. This flexibility facilitates the current nationwide lending activities of Discover Bank and Bank of New Castle.

The FDIA subjects us to deposit insurance assessments. Under the Reform Act, in order to bolster the reserves of the Deposit Insurance Fund, the minimum reserve ratio set by the FDIC was increased to 1.35%. The FDIC recently set a reserve ratio of 2%, 65 basis points above the statutory minimum. The FDIC has also approved two rules that amend its deposit insurance regulations. The first implements a provision of the Reform Act that changes the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average tangible equity. The second revises the risk-based assessment system for all large insured depository institutions (generally, institutions with at least $10 billion in total assets, including Discover Bank) to one based on a scorecard method. Further increases may occur in the future. The Reform Act has removed the statutory cap for the reserve ratio, leaving the FDIC free to set a cap in the future.

Acquisitions and Investments

Since we are a bank holding company, and Discover Bank and Bank of New Castle are insured depository institutions, we are subject to banking laws and regulations that limit the types of acquisitions and investments that we can make. In addition, certain permitted acquisitions and investments that we seek to make are subject to the prior review and approval of our banking regulators, including the Federal Reserve and FDIC. Our banking regulators have broad discretion on whether to approve proposed acquisitions and investments. In deciding whether to approve a proposed acquisition, federal bank regulators will consider, among other factors, the effect of the acquisition on competition, financial condition, and future prospects including current and projected capital ratios and levels; the competence,

experience, and integrity of management and record of compliance with laws and regulations; the convenience and needs of the communities to be served, including our record of compliance under the Community Reinvestment Act; and our effectiveness in combating money laundering.
In addition, certain acquisitions of our voting stock may be subject to regulatory approval or notice under U.S. federal or Delaware state law. Investors are responsible for ensuring that they do not, directly or indirectly, acquire shares of our stock in excess of the amount that can be acquired without regulatory approval under the Change in Bank Control Act, the Bank Holding Company Act and the Delaware Change in Bank Control provisions, which prohibit any person or company from

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acquiring control of us without, in most cases, the prior written approval of each of the FDIC, the Federal Reserve and the Delaware Commissioner.

Consumer Financial Services

The relationship between us and our U.S. customers is regulated extensively under federal and state consumer protection laws. Federal laws include the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Gramm-Leach-Bliley Act, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD Act") and the Reform Act. Moreover, our U.S. banking subsidiaries are subject to the Servicemembers Civil Relief Act, which protects persons called to active military service and their dependents from undue hardship resulting from their military service. The Servicemembers Civil Relief Act applies to all debts incurred prior to the commencement of active duty (including credit card and other open-end debt) and limits the amount of interest, including service and renewal charges and any other fees or charges (other than bona fide insurance) that is related to the obligation or liability. These and other federal laws, among other things, require disclosures of the cost of credit, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, require safe and sound banking operations, prohibit unfair and deceptive trade practices, restrict our ability to raise interest rates, and subject us to increased regulatory oversight. State, and in some cases local, laws also may regulate in these areas as well as the areas of collection practices and provide other additional consumer protections.

Violations of applicable consumer protection laws can result in significant potential liability in litigation by customers, including civil monetary penalties, actual damages, restitution and attorneys' fees. Federal banking regulators, as well as state attorneys general and other state and local consumer protection agencies, also may seek to enforce consumer protection requirements and obtain these and other remedies.

The CARD Act was enacted in 2009, but most of the requirements became effective in 2010. The CARD Act made numerous changes to the Truth in Lending Act, requiring us to make fundamental changes to many of our business practices, including marketing, underwriting, pricing and billing. The CARD Act's restrictions on our ability to increase interest rates on existing balances to respond to market conditions and credit risk ultimately limits our ability to extend credit to new customers and provide additional credit to current customers. Other CARD Act restrictions have resulted and will continue to result in reduced interest income and loan fee income. For more information, see “Risk Factors - The Credit Card Accountability Responsibility and Disclosure Act of 2009 restricts our business practices and negatively impacts our results of operations.”

The Reform Act established the CFPB, which regulates consumer financial products and services provided by certain financial services providers, including Discover. In July 2011, many consumer financial protection functions formerly assigned to the federal banking and other agencies transferred to the CFPB. For more information, see “Risk Factors - The Consumer Financial Protection Bureau may increase our compliance costs and have a significant impact on our business” and “Management's Discussion and Analysis of Financial Condition and Results of Operations - Regulatory Environment and Developments - Consumer Financial Services.”

Payment Networks

We operate the Discover and PULSE networks, which deliver switching and settlement services to financial institutions and other program participants for a variety of ATM, POS and other electronic banking transactions. These operations are regulated by certain federal and state banking, privacy and data security laws. Moreover, the Discover and PULSE networks are subject to examination under the oversight of the Federal Financial Institutions Examination Council, an interagency body composed of the federal bank and thrift regulators, and the National Credit Union Association. In addition, as our payments business has expanded globally through Diners Club, we are subject to government regulation in countries in which our networks operate or our cards are used, either directly or indirectly through regulation affecting Diners Club network licensees. Changes in existing federal, state or international regulation could increase the cost or risk of providing network services, change the competitive environment, or otherwise materially adversely affect our operations. The legal environment regarding privacy and data security is particularly dynamic, and any unpermitted disclosure of confidential customer information could have a material adverse impact on our business, including loss of consumer confidence.

The Reform Act contains several provisions that may affect the business practices, network transaction volume, revenue, and prospects for future growth of PULSE, our debit card business. The Reform Act requires that merchants control the routing of debit transactions, and that interchange fees received by certain payment card issuers on debit card transactions be "reasonable and proportional" to the issuer's cost in connection with such transactions, as determined by the Federal Reserve. The Reform Act also requires the Federal Reserve to restrict debit card networks and issuers from requiring debit card transactions to be processed solely on a single payment network or two or more affiliated networks, or from requiring that transactions be routed over certain networks. For information regarding implementation of these provisions and potential impacts on our debit card business, see "Risk Factors - Legislative and regulatory reforms related to the debit card market may have a significant impact on our PULSE network business and may result in decreases in our PULSE network volume and revenue" and "Management's Discussion and Analysis of Financial Condition and Results of Operations - Regulatory

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Environment and Developments - Payment Networks."

Money Laundering & Terrorist Financing Prevention Program

We maintain an enterprise-wide program designed to comply fully with all applicable anti-money laundering and anti-terrorism laws and regulations, including the Bank Secrecy Act and the USA PATRIOT Act of 2001. This program includes policies, procedures, training and other internal controls designed to mitigate the risk of money laundering or terrorist financing posed by our products, services, customers and geographic locale. These controls include procedures and processes to detect and report suspicious transactions, perform customer due diligence, and meet all recordkeeping and reporting requirements related to particular transactions involving currency or monetary instruments. The program is coordinated by a compliance officer and undergoes an annual, independent audit to assess its effectiveness.

Sanctions Programs

We have a program designed to comply with applicable economic and trade sanctions programs, including those administered and enforced by the U.S. Department of the Treasury's Office of Foreign Assets Control. These sanctions are usually targeted against foreign countries, terrorists, international narcotics traffickers and those believed to be involved in the proliferation of weapons of mass destruction. These regulations generally require either the blocking of accounts or other property of specified entities or individuals, but they may also require the rejection of certain transactions involving specified entities or individuals. We maintain policies, procedures and other internal controls designed to comply with these sanctions programs.

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Executive Officers of the Registrant

Set forth below is information concerning our executive officers, each of whom is a member of our Executive Committee.

Name	Age	Position
David W. Nelms	50	Chairman and Chief Executive Officer
Roger C. Hochschild	47	President and Chief Operating Officer
R. Mark Graf	47	Executive Vice President and Chief Financial Officer
Kathryn McNamara Corley	51	Executive Vice President, General Counsel and Secretary
Carlos Minetti	49	Executive Vice President, President - Consumer Banking and Operations
Diane E. Offereins	54	Executive Vice President, President - Payment Services
Mary Oleksiuk	50	Senior Vice President and Chief Human Resources Officer
James V. Panzarino	59	Executive Vice President and Chief Credit Risk Officer
Glenn Schneider	50	Senior Vice President and Chief Information Officer
Harit Talwar	51	Executive Vice President, President - U.S. Cards

David W. Nelms has served as our Chairman since January 2009 and our Chief Executive Officer since 2004, and was also our Chairman from 2004 until our spin-off from Morgan Stanley in 2007. He was our President and Chief Operating Officer from 1998 to 2004. Prior to joining us, Mr. Nelms worked at MBNA America Bank from 1990 to 1998, most recently as Vice Chairman. Mr. Nelms holds a Bachelor's of Science degree in Mechanical Engineering from the University of Florida and an M.B.A. from Harvard Business School.

Roger C. Hochschild has served as President and Chief Operating Officer since 2004, and was Executive Vice President, Chief Marketing Officer from 1998 to 2001. From 2001 to 2004, Mr. Hochschild was Executive Vice President, Chief Administrative Officer and Chief Strategic Officer of our former parent Morgan Stanley. Mr. Hochschild holds a Bachelor's degree in Economics from Georgetown University and an M.B.A. from the Amos Tuck School at Dartmouth College.

R. Mark Graf has served as Executive Vice President, Chief Financial Officer and Chief Accounting Officer since April 2011. Prior to joining us, Mr. Graf was an investment advisor with Aquiline Capital Partners, a private equity firm specializing in investments in the financial services industry. From 2006 to 2008, Mr. Graf was a partner at Barrett Ellman Stoddard Capital. Mr. Graf was Executive Vice President and Chief Financial Officer for Fifth Third Bank from 2004 to 2006, after having served as its Treasurer from 2001 to 2004. He holds a Bachelor's degree from the Wharton School of the University of Pennsylvania.

Kathryn McNamara Corley has served as Executive Vice President, General Counsel and Secretary since February 2008. Prior thereto, she served as Senior Vice President, General Counsel and Secretary since 1999. Prior to becoming General Counsel, Ms. Corley was Managing Director for our former parent Morgan Stanley's global government and regulatory relations. Ms. Corley holds a Bachelor's degree in Political Science from the University of Southern California and a J.D. from George Mason University School of Law.

Carlos Minetti has served as Executive Vice President, President - Consumer Banking and Operations since April 2010. Prior thereto, he served as Executive Vice President, Cardmember Services and Consumer Banking, and since September 2006, Executive Vice President, Cardmember Services and Risk Management. Prior to joining us as Executive Vice President, Cardmember Services in January 2001, Mr. Minetti worked in card operations and risk management for American Express from 1987 to 2000, most recently as Senior Vice President. Mr. Minetti holds a Bachelor's of Science degree in Industrial Engineering from Texas A & M University and an M.B.A. from the University of Chicago.

Diane E. Offereins has served as Executive Vice President, President - Payment Services since April 2010. Prior thereto, she served as Executive Vice President, Payment Services since December 2008 and Executive Vice President and
Chief Technology Officer since 1998. In addition, she was appointed to oversee the PULSE network in 2006. From 1993 to 1998, Ms. Offereins was at MBNA America Bank, most recently as Senior Executive Vice President.
Ms. Offereins holds a Bachelor's of Business Administration degree in Accounting from Loyola University.

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Mary Oleksiuk has served as Senior Vice President and Chief Human Resources Officer since October 2011. Prior to joining us, Ms. Oleksiuk served as Senior Vice President, Global Human Resources, with Alberto Culver Company. From 2005 to 2007, Ms. Oleksiuk was an officer with Limited Brands where she served as Executive Vice President, Human Resources, for the Bath & Body Works division from 2006 to 2007. Ms. Oleksiuk holds a Bachelor’s degree from Wayne State University and a Master’s degree from the University of Illinois.

James V. Panzarino has served as Executive Vice President and Chief Credit Risk Officer since December 2009. Prior thereto, he served as Senior Vice President and Chief Credit Risk Officer from 2006 to 2009, and Senior Vice President, Cardmember Assistance, from 2003 to 2006. Prior to joining us, Mr. Panzarino was Vice President of External Collections and Recovery at American Express from 1998 to 2002. Mr. Panzarino holds a Bachelor's degree in Business Management and Communication from Adelphi University.

Glenn Schneider has served as Senior Vice President and Chief Information Officer since December 2008, and was appointed to our Executive Committee in December 2009. From 2003 to 2008, he was Senior Vice President, Application Development, and from 1998 to 2003, he served as Vice President, Marketing Applications.

Mr. Schneider joined us in 1993. He holds a Bachelor's degree in Economics/Computer Science and a minor in Statistics from Northern Illinois University.

Harit Talwar has served as Executive Vice President, President - U.S. Cards since April 2010. Prior thereto, he served as Executive Vice President, Card Programs and Chief Marketing Officer since December 2008 and Executive Vice President, Discover Network since December 2003. From 2000 to 2003, Mr. Talwar was Managing Director for our international business. Mr. Talwar held a number of positions at Citigroup from 1985 to 2000, most recently as Country Head, Consumer Banking Division, Poland. Mr. Talwar holds a B.A. Hons degree in Economics from Delhi University in India and an M.B.A. from the Indian Institute of Management, Ahmedabad.

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Item 1A. Risk Factors
You should carefully consider each of the following risks described below and all of the other information in this annual report on Form 10-K in evaluating us. Our business, financial condition, cash flows and/or results of operations could be materially adversely affected by any of these risks. The trading price of our common stock could decline due to any of these risks. This annual report on Form 10-K also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this annual report on Form 10-K. See "Special Note Regarding Forward-Looking Statements," which immediately follows the risks below.
Economic conditions have had and could have a material adverse effect on our business, results of operations, financial condition and stock price.
While certain economic conditions in the United States have shown signs of improvement, economic growth has been slow and uneven as consumers continue to be affected by high unemployment rates and depressed housing values. In addition, recent concerns and events such as economic uncertainty surrounding financial regulatory reform and its effect on the revenues of financial services companies, U.S. debt and budget matters and the sovereign debt crisis in Europe, may continue to impact economic recovery and the financial services industry. A prolonged period of slow economic growth or a significant deterioration in economic conditions would likely affect the ability and willingness of customers to pay amounts owed to us. A customer's ability to repay us also can be negatively impacted by increases in their payment obligations to other lenders under mortgage, credit card and other consumer loans. Although delinquencies and charge-offs declined significantly in 2011, we believe that we are experiencing historical lows in these rates and that they are likely to increase. In addition, if economic conditions do not improve, these rates may increase more than expected. The over 30 days delinquent rate was 2.30% at November 30, 2011, down from 3.89% at November 30, 2010, and the full-year net charge-off rate was 3.99% for 2011, down from 7.57% for 2010.
As our delinquency and charge-off rates rise, we expect to increase our allowance for loan losses. Due in part to improvements in certain economic indicators, our provision for loan losses has declined substantially, to $1.0 billion for the 2011 fiscal year, as compared to $3.2 billion for the 2010 fiscal year. Lower levels of delinquency and charge-offs reduced our reserve requirements and led to reserve releases in 2011, which significantly contributed to our net income growth. Growth in our loan portfolio, along with stagnant or worsening economic conditions, would contribute to rising delinquency and charge-offs and increases in our allowance for loan losses, which could negatively impact our net income.
Our business is always influenced by economic conditions. Poor economic conditions not only affect the ability and willingness of customers to pay amounts owed to us, increasing delinquencies, charge-offs and allowance for loan losses as described above, but can also reduce the usage of our cards and the average purchase amount of transactions on our cards, which reduces our interest income and transaction fees. We rely heavily on interest income from our credit card business to generate earnings. Our interest income from credit card loans was $5.7 billion for the 2011 fiscal year, which was 80% of revenues (defined as net interest income plus other income), compared to $5.8 billion in the 2010 fiscal year, which was 88% of revenues.
Economic conditions may also cause our earnings to fluctuate and diverge from expectations of securities analysts and investors, who may have differing assumptions regarding their impact on our business and, therefore, may impact the trading price of our common stock.
The regulatory environment for the financial services industry is being significantly impacted by financial regulatory reform initiatives, which may adversely impact our business, results of operations and financial condition.
The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Reform Act") contains a comprehensive set of provisions designed to govern the practices and oversight of financial institutions and other participants in the financial markets. The Reform Act addresses risks to the economy and the payments system posed by large systemically significant financial firms, including us, through a variety of measures, including increased capital and liquidity requirements, limits on leverage, and enhanced supervisory authority. The Reform Act also establishes a new financial industry regulator, the Consumer Financial Protection Bureau ("CFPB"), and includes new requirements for debit card transactions, which impact our core businesses and are described in more detail below. Our banking regulators have introduced and continue to introduce new regulations and supervisory guidance and practices in

response to the heightened Congressional and regulatory focus on financial services generally, increasing their scrutiny over us and the industry. Also, additional legislative or regulatory action that may impact our business may result from the multiple studies mandated under the Reform Act. We are unable to predict the nature, extent or impact of any additional changes to statutes or regulations, including the interpretation or implementation thereof, which may occur in the future.

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The effect of the Reform Act and other regulatory initiatives on our business and operations could be significant, depending upon final implementing regulations, the actions of our competitors and the behavior of consumers and other marketplace participants. The Reform Act, other legislative and regulatory changes, and enhanced scrutiny by our regulators could have a significant impact on us by, for example, requiring us to limit or change our business practices, limiting our ability to pursue business opportunities, requiring us to invest valuable management time and resources in compliance efforts, imposing additional costs on us, limiting fees we can charge for services, requiring us to meet more stringent capital, liquidity and leverage ratio requirements (including those under Basel III), impacting the value of our assets, increasing our cost or ability to access the securitization markets for our funding, or otherwise adversely affecting our businesses. The Reform Act, its implementing regulations, and any other significant financial regulatory reform initiatives could have a material adverse effect on our business, results of operations, cash flows and financial condition. A more comprehensive description of the Reform Act is contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations - Regulatory Environment and Developments."

For additional information regarding the risks we face in connection with the Reform Act and other laws and regulations, see the following risk factors below: "The Consumer Financial Protection Bureau may increase our compliance costs and have a significant impact on our business," "Legislative and regulatory initiatives related to the student loan market may have a significant impact on our strategy of profitably growing our student loan portfolio," "Legislative and regulatory reforms related to the debit card market may have a significant impact on our PULSE network business and may result in decreases in our PULSE network volume and revenue," "The Credit Card Accountability Responsibility and Disclosure Act of 2009 restricts our business practices and negatively impacts our results of operations," "If we are unable to securitize our receivables, it may have a material adverse effect on our liquidity, cost of funds and overall financial condition," "We may be limited in our ability to pay dividends and repurchase our common stock," "Laws, regulations, and supervisory guidance and practices, or the application thereof, may adversely affect our business, financial condition and results of operations," "Current and proposed regulation addressing consumer privacy and data use and security could inhibit the number of payment cards issued and increase our costs," and "Litigation and regulatory actions could subject us to significant fines, penalties and/or requirements resulting in increased expenses."

The Consumer Financial Protection Bureau may increase our compliance costs and have a significant impact on our business.

In July 2011, many consumer financial protection functions formerly assigned to the federal banking and other agencies transferred to the CFPB. The CFPB has a large budget and staff, and has broad authority with respect to the businesses in which we engage. It has authority to write regulations under federal consumer financial protection laws, and enforce those laws against and examine large financial institutions, including Discover, for compliance. It is authorized to collect fines and provide consumer restitution in the event of violations, engage in consumer financial education, track consumer complaints, request data and promote the availability of financial services to underserved consumers and communities. In late 2011, the CFPB began tracking consumer complaints for credit cards and mortgages via an online process that is expected to expand to student loans in 2012. It has authority to prevent "unfair, deceptive or abusive" practices by issuing regulations or by using its enforcement authority without first establishing regulatory guidance.

Because the CFPB has been recently established and its Director has been only recently appointed, there is significant uncertainty as to how the CFPB will exercise and implement its regulatory, supervisory, examination and enforcement authority. Depending on how the CFPB functions and its areas of focus, it could have a material adverse impact on our businesses. The CFPB is expected to establish multiple divisions, each with its own rule writing and compliance examination specialists, to focus on businesses in which we engage or expect to engage (such as revolving loans, student loans, mortgages, other consumer loans and payments). Changes in regulatory expectations, interpretations or practices could increase the risk of regulatory enforcement actions, fines and penalties. In addition to increasing our compliance costs and potentially delaying our ability to respond to marketplace changes, actions by the CFPB could result in requirements to alter our products and services that would make our products less attractive to consumers and impair our ability to offer them profitably. Should the CFPB discourage the use of products we offer or steer

consumers to other products or services that it deems to be preferable, we could suffer reputational harm and a loss of customers. The CFPB's authority to change regulations adopted in the past by other regulators (e.g., regulations issued under the Truth in Lending Act or the Credit Card Accountability Responsibility and Disclosure Act of 2009, or the CARD Act, by the Federal Reserve), or to rescind or ignore past regulatory guidance, could increase our compliance costs and litigation exposure. Our litigation exposure may also be increased by the CFPB's authority to limit or ban pre-dispute arbitration clauses.

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The Reform Act authorizes state officials to enforce regulations issued by the CFPB and to enforce the Reform Act's general prohibition against unfair, deceptive or abusive practices, and makes it more difficult than in the past for federal financial regulators to declare state laws that differ from federal standards to be preempted. To the extent that states enact requirements that differ from federal standards or state officials and courts adopt interpretations of federal consumer laws that differ from those adopted by the CFPB, we may be required to alter or cease offering products or services in some jurisdictions, which would increase compliance costs and reduce our ability to offer the same products and services to consumers nationwide, and we may be subject to a higher risk of state enforcement actions.

Legislative and regulatory initiatives related to the student loan market may have a significant impact on our strategy of profitably growing our student loan portfolio.

We have invested in the growth of our private student loan portfolio, including through the acquisition of SLC in December 2010 and the acquisition of additional private student loans in September 2011. Our total student loans have grown from $1.0 billion at November 30, 2010 to $7.3 billion at November 30, 2011. There is significant legislative and regulatory focus on the student loan market, including by the CFPB, which has made it a priority area of focus. Under the Reform Act, the CFPB and Department of Education (“DOE”) are required to prepare a report on private education loans and private educational lenders by July 2012 that examines, among other things, the private education loan market; underwriting criteria used by lenders; loan terms, conditions and pricing; consumer protections available to borrowers; and fair lending considerations. The Reform Act also created a "Private Education Ombudsman" within the CFPB to receive and attempt to informally resolve complaints about private student loans, and the CFPB plans to receive such complaints via its online consumer complaint system. In addition, the Obama Administration has made changes to the federal student loan program intended to make college more affordable and make it easier for students to repay their federal student loans. Congress or the Administration may take actions that impact the student loan market in the future, including as a result of the CFPB and DOE study. The possible impact of heightened scrutiny of the student loan market and its participants, including any resulting legislative and regulatory initiatives, is uncertain and may adversely impact the profitability and growth of our private student loan portfolio.

Legislative and regulatory reforms related to the debit card market may have a significant impact on our PULSE network business and may result in decreases in our PULSE network volume and revenue.

The Reform Act contains several provisions that may adversely affect our PULSE network's business practices, network transaction volume, revenue, and prospects for future growth. First, the Reform Act requires that interchange fees received by certain payment card issuers on debit card transactions be “reasonable and proportional” to the issuer's cost in connection with such transactions, as determined by the Federal Reserve. The Federal Reserve also has the power to regulate network fees to the extent necessary to prevent circumvention of interchange regulation under the Reform Act. In addition, the Reform Act requires the Federal Reserve to restrict debit card networks and issuers from requiring debit card transactions to be processed solely on a single payment network or two or more affiliated networks, or from requiring that transactions be routed over certain networks. The Federal Reserve issued final implementing regulations with respect to the interchange fee and routing provisions in June 2011, some of which became effective in October 2011. Regulations mandating that debit and prepaid card issuers participate in two or more unaffiliated payment networks take effect April 1, 2012. Discover Network and PULSE have modified operating rules, interchange fee schedules and existing agreements to ensure consistency with the Reform Act and Federal Reserve implementing regulations. PULSE has increased its processing capacity for potential additional volume.

The Reform Act requirements may significantly affect the debit card market, decrease prospects for future growth of debit products, negatively impact PULSE's transaction volume and revenue, and require costly system changes. For example, the network participation requirements impact PULSE's ability to enter into exclusivity arrangements, which affect PULSE's current business practices and may materially adversely affect its network transaction volume and revenue. Our transaction processing revenue was $180 million and $150 million for the years ended November 30, 2011 and 2010, respectively. The ultimate impact of these laws and regulations will depend upon the actions of our competitors and the behavior of other marketplace participants. For example, the National Retail Federation, the Food Marketing Institute, the National Association of Convenience Stores and two retailers have filed a federal lawsuit

challenging the Federal Reserve implementing regulations and, in particular, the interchange fee provisions, on the grounds that, among other things, the Federal Reserve did not properly apply the Reform Act. It is uncertain how PULSE's business practices, network transaction volume, revenue, and prospects for future growth, as well as the debit card market as a whole, may be impacted by the industry's competitive response to these new requirements.

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The Credit Card Accountability Responsibility and Disclosure Act of 2009 restricts our business practices and negatively impacts our results of operations.
The Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD Act") has required us to make fundamental changes to many of our business practices, including marketing, underwriting, pricing and billing. The CARD Act's restrictions on our ability to increase interest rates on existing balances to respond to market conditions and credit risk ultimately limits our ability to extend credit to new customers and provide additional credit to current customers. Other CARD Act restrictions with respect to allocation of payments on accounts and adjustments to interest rates have resulted and will continue to result in reduced interest income. We rely heavily on interest income. Our interest income from credit card loans was $5.7 billion for the 2011 fiscal year, which was 80% of revenues (defined as net interest income plus other income), compared to $5.8 billion in the 2010 fiscal year, which was 88% of revenues. The CARD Act's restrictions on late and other penalty fees have reduced our loan fee income and may impact our ability to deter late payments. Our loan fee income was $338 million for the 2011 fiscal year, compared to $340 million in the 2010 fiscal year, which was 5% of revenues in each year.
We have made changes to our pricing, credit and marketing practices designed to lessen the impact of the changes required by the CARD Act. The long-term impact of the CARD Act on credit card industry profitability generally, and on our business practices and revenues, continue to depend upon consumer behavior and the actions of our competitors, which remain difficult to predict. Consumers may generally choose to use credit cards less frequently or for smaller dollar amounts. We may have to reconsider certain strategies in order to remain competitive. For example, in the event of another market downturn, we may have to consider expense-reduction initiatives in order to offset our inability to generate increased interest and fee income due to the CARD Act's repricing restrictions. If the changes we have made and may make in the future to offset the impact of the CARD Act are not effective in the long term, they may have a material adverse effect on our business and results of operations.
We face competition from other consumer financial services providers, and we may not be able to compete effectively, which could result in fewer customers and lower account balances and could materially adversely affect our financial condition, cash flows and results of operations.
The consumer financial services business is highly competitive. We compete with other consumer financial services providers on the basis of a number of factors, including brand, reputation, customer service, product offerings, incentives, pricing and other terms. Competition in credit cards is also based on merchant acceptance and the value provided to the customer by rewards programs. Many credit card issuers have instituted rewards programs that are similar to ours, and, in some cases, are more attractive to customers than our programs. These competitive factors affect our ability to attract and retain customers, increase usage of our products, and maximize the revenue generated by our products. In addition, because most domestically issued credit cards, other than those issued by American Express, are issued on the Visa and MasterCard networks, most other card issuers benefit from the dominant position and marketing and pricing power of Visa and MasterCard. If we are unable to compete successfully, or if competing successfully requires us to take aggressive actions in response to competitors' actions, our financial condition, cash flows and results of operations could be materially adversely affected.
We incur considerable expenses in competing with other consumer financial services providers, and many of our competitors have greater financial resources than we do, which may place us at a competitive disadvantage and negatively affect our financial results.
We incur considerable expenses in competing with other consumer financial services providers to attract and retain customers and increase usage of our products. A substantial portion of these expenses relates to marketing expenditures. We incurred expenses of $537 million and $463 million in the 2011 and 2010 fiscal years, respectively, for marketing and business development. Our consumer financial services products compete primarily on the basis of pricing, terms and service. Because of the highly competitive nature of the credit card issuing business, a primary method of competition among credit card issuers, including us, has been to offer rewards programs, low introductory interest rates, attractive standard purchase rates and balance transfer programs that offer a favorable annual percentage rate or other financial incentives for a specified length of time on account balances transferred from another credit card. This type of competition has adversely affected credit card yields, and customers may frequently switch credit cards or transfer their balances to another card. There can be no assurance that any of the expenses we incur or

incentives we offer to attempt to acquire and maintain accounts and increase usage of our products will be effective. Furthermore, many of our competitors are larger than we are, have greater financial resources than we do, have more breadth in consumer banking products, and/or have lower funding and operating costs than we have and expect to have, and have assets such as branch locations and co-brand relationships, that may help them compete more effectively. We may be at a competitive disadvantage as a result of the greater financial resources, diversification and scale of many of our competitors.

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Our expenses directly affect our earnings results. Many factors can influence the amount of our expenses, as well as how quickly they may increase. Our ongoing investments in infrastructure, which may be necessary to maintain a competitive business, integrate newly-acquired businesses, and establish scalable operations, may increase our expenses. In addition, as our business develops, changes or expands, additional expenses can arise as a result of a reevaluation of business strategies, management of outsourced services, asset purchases, structural reorganization, compliance with new laws or regulations or the integration of newly-acquired businesses. If we are unable to successfully manage our expenses, our financial results will be negatively affected.

We face competition from other operators of payment networks, and we may not be able to compete effectively, which could result in reduced transaction volume, limited merchant acceptance of our cards, limited issuance of cards on our networks by third parties and materially reduced earnings.

We face substantial and increasingly intense competition in the payments industry. We compete with other payment networks to attract third-party issuers to issue credit and debit cards and other card products on the Discover, PULSE and Diners Club networks. Competition with other operators of payment networks is generally based on issuer interchange fees, fees paid to networks (including switch fees), merchant acceptance, network functionality and other economic terms. Competition also is based on customer perception of service quality, brand image, reputation and market share.

Many of our competitors are well established, larger than we are and/or have greater financial resources than we do. These competitors have provided financial incentives to card issuers, such as large cash signing bonuses for new programs, funding for and sponsorship of marketing programs and other bonuses. Visa and MasterCard each have been in existence for more than 40 years and enjoy greater merchant acceptance and broader global brand recognition than we do. Although we have made progress in merchant acceptance, we have not achieved global market parity with Visa and MasterCard. In addition, Visa and MasterCard have entered into long-term arrangements with many financial institutions that may have the effect of discouraging those institutions from issuing credit cards on the Discover Network or issuing debit cards on the PULSE network. Some of these arrangements are exclusive, or nearly exclusive, which further limits our ability to conduct material amounts of business with these institutions. If we are unable to remain competitive on issuer interchange and other incentives, we may be unable to offer adequate pricing to third-party issuers while maintaining sufficient net revenues. At the same time, increasing the transaction fees charged to merchants or increasing acquirer interchange could adversely affect our effort to increase merchant acceptance of credit cards issued on the Discover Network and may cause merchant acceptance to decrease. This, in turn, could adversely affect our ability to attract third-party issuers and our ability to maintain or grow revenues from our proprietary network. The Reform Act, which gives merchants control of the routing of debit transactions, could also result in a decrease in volume and revenue for the PULSE network.

American Express is also a strong competitor, with international acceptance, high transaction fees and an upscale brand image. Internationally, American Express competes in the same market segments as Diners Club. We may face challenges in increasing international acceptance on our networks, particularly if third parties that we rely on to issue Diners Club cards, increase card acceptance, and market our brands do not perform to our expectations.

In addition, if we are unable to maintain sufficient network functionality to be competitive with other networks, or if our competitors develop better data security solutions or more innovative products and services than we do, our ability to attract third-party issuers and maintain or increase the revenues generated by our proprietary card issuing business may be materially adversely affected. An inability to compete effectively with other payment networks could result in reduced transaction volume, limited merchant acceptance of our cards, limited issuance of cards on our network by third parties and materially reduced earnings.

Our business depends upon relationships with issuers, merchant acquirers and licensees, which are generally financial institutions. The adverse economic and regulatory environment and increased consolidation in the financial services industry decrease our opportunities for new business and may result in the termination of existing business relationships if a business partner is acquired or goes out of business. In addition, as a result of this environment, financial institutions may have decreased interest in engaging in new card issuance opportunities or expanding existing card issuance relationships, which would inhibit our ability to grow our payment services business.

If we are unsuccessful in maintaining the Diners Club network and achieving full card acceptance across our networks, we may be unable to sustain and grow our international network business.

In 2008, we acquired the Diners Club network, brand, trademarks, employees, and license agreements. We have made significant progress toward, but have not completed, achieving full card acceptance across the Diners Club network, the Discover Network and PULSE. This would allow Discover customers to use their cards at merchant and ATM locations that accept Diners Club cards around the world and would allow Diners Club customers to use their cards on the Discover Network in North America and on the PULSE network both domestically and internationally.

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The success of our Diners Club business depends upon our ability to maintain the full operability of the Diners Club network for existing Diners Club cardholders, network licensees and merchants. Citigroup owns and operates network licensees generating a significant share of the Diners Club network sales volume. Citigroup has been reducing assets outside its core businesses, including certain Diners Club businesses, by selling its ownership interest. If Citigroup were to discontinue its support of a significant number of or key Diners Club network licensees, we may face difficulty maintaining and growing our international network. This could adversely affect the acceptance of Discover cards when they are used outside of North America.

The success of our Diners Club business depends upon the cooperation and support of the network licensees that issue Diners Club cards and that maintain a merchant acceptance network. As is the case for other card payment networks, Diners Club does not issue cards or determine the terms and conditions of cards issued by the network licensees. This is the responsibility of each licensee. Further, unlike the Discover Network, we have only a small number of direct merchant relationships in the Diners Club network. Instead, we rely on network licensees located outside the United States to help us sustain and grow our international business. As a result of a number of factors, including any difficulties in achieving full card acceptance across our networks, network licensees may choose not to renew the license agreements with us when their terms expire. In addition, the increasingly competitive marketplace for cross-border issuance and acceptance of credit cards may result in lower participation fees for the Diners Club network. In addition, many of the merchants in the acceptance network, primarily small and mid-size merchants, may not be contractually committed to the network licensees for any period of time and may cease to participate in the Diners Club network at any time on short notice. If we are unable to continue our relationships with network licensees or if the network licensees are unable to continue their relationships with merchants, our ability to maintain or increase revenues and to remain competitive would be adversely affected. Interruption of these relationships might also have an adverse effect on the acceptance of Discover cards when they are used on the Diners Club network outside of North America.

We rely upon numerous other network partners for merchant acceptance for existing Diners Club customers. We completed rerouting merchant transactions for foreign Diners Club cards transacting in North America from the MasterCard acceptance network to the Discover Network in 2011. If we are unable to continue to offer acceptable North American merchant acceptance to Diners Club customers, we may experience decreased transaction volume, which would reduce our revenues. Also, as we have nonamortizable intangible assets that resulted from the purchase of Diners Club, if we are unable to maintain or increase revenues due to the reasons described above, we may be exposed to an impairment loss that, when recognized, could have a material adverse impact on our consolidated financial condition and results of operations. The long-term success of our acquisition of Diners Club depends upon achieving full card acceptance across our networks, which could include higher overall costs or longer timeframes than anticipated. If we are unable to successfully achieve full card acceptance across our networks, we may be unable to achieve the synergies we anticipate and to grow our business internationally.

The success of our student loan strategy depends upon our ability to fully integrate The Student Loan Corporation. If we fail to do so, we may be unable to sustain and grow our student loan portfolio.

In December 2010, we purchased SLC and, in September 2011, we purchased additional private student loans from Citi. The acquisitions significantly increased the size of our private student loan portfolio, which has grown from $1.0 billion at November 30, 2010 to $7.3 billion at November 30, 2011. The success of these acquisitions depends, in part, upon our ability to manage the risks resulting from our relatively recent entry into the student loan market.

We are relying heavily on the assistance of Citi and certain of its affiliates during a transition period for many services, including services related to operations, technology, marketing and origination. If we are unable to assume responsibility for these services during the established transition period, we will need to enter into an extension of our agreement with Citi or identify other service providers, which may not be available on favorable pricing or terms, if at all. If we were to lose the support of Citi before these services were successfully transitioned to our employees or another service provider, we could experience interruptions in operations that could negatively impact our ability to meet customer demand for student loan originations and disbursements, damage our relationships with schools, customers and vendors, and reduce our market share in the student loan market, all of which could adversely affect our student loan strategy and results of operations.

The long-term success of our student loan strategy depends upon our ability to manage the credit risk, pricing, funding, operations and expenses of a larger student loan portfolio as well as the successful implementation of our brand strategy. We currently originate student loans under the Discover brand and acquire student loans from Citi that are marketed under the CitiAssist brand; however, our agreement with Citi regarding CitiAssist student loans is expected to expire at the end of 2012. In the 2011 fiscal year, 57% of our newly-disbursed private student loans were originated by Citi under the CitiAssist brand. Our ability to maintain or increase market share is largely dependent upon our ability to migrate to a single, cohesive suite of student loan products marketed under the Discover brand, as well as our ability to communicate effectively to prospective borrowers and schools about these products. We plan to continue to offer competitively priced products by managing our

expenses through building economies of scale, which will reduce our origination and servicing costs. If we are unable to accomplish these objectives, it may have a negative impact on our results of operations, affect our competitive position in the marketplace and prevent us from sustaining and growing our student loan portfolio.

Our framework for managing risks may not be effective in mitigating our risk of loss.

Our risk management framework seeks to mitigate risk and appropriately balance risk and return. We have established processes and procedures intended to identify, measure, monitor and report the types of risk to which we are subject, including credit risk, market risk, liquidity risk, operational risk, legal and compliance risk, and strategic risk. We seek to monitor and control our risk exposure through a framework of policies, procedures and reporting requirements. Management of our risks in some cases depends upon the use of analytical and/or forecasting models. If the models that we use to mitigate these risks are inadequate, we may incur increased losses. In addition, there may be risks that exist, or that develop in the future, that we have not appropriately anticipated, identified or mitigated. If our risk management framework does not effectively identify or mitigate our risks, we could suffer unexpected losses and our financial condition and results of operations could be materially adversely affected.

Our business depends on our ability to manage our credit risk, and failing to manage this risk successfully may result in high charge-off rates, which would materially adversely affect our business, profitability and financial condition.

Our success depends on our ability to manage our credit risk while attracting new customers with profitable usage patterns. We select our customers, manage their accounts and establish terms and credit limits using proprietary scoring models and other analytical techniques that are designed to set terms and credit limits to appropriately compensate us for the credit risk we accept, while encouraging customers to use their available credit. The models and approaches we use may not accurately predict future charge-offs due to, among other things, inaccurate assumptions. While we continually seek to improve our assumptions and models, we may make modifications that unintentionally cause them to be less predictive or we may incorrectly interpret the data produced by these models in setting our credit policies.

Our ability to manage credit risk and avoid high charge-off rates may be adversely affected by economic conditions that may be difficult to predict, such as the recent financial crisis. Although delinquencies and charge-offs declined significantly in 2011, we believe that we are experiencing historical lows in these rates and that they are likely to increase. In addition, if economic conditions do not improve, these rates may increase more than expected. The full-year net charge-off rate was 3.99% in 2011, down from the full-year net charge-off rate of 7.57% in 2010. At November 30, 2011 and 2010, $718 million, or 1.25%, and $1.2 billion, or 2.42%, of our loan receivables were non-performing (defined as loans over 90 days delinquent and accruing interest plus loans not accruing interest). We remain subject to conditions in the consumer credit environment. There can be no assurance that our underwriting and portfolio management strategies will permit us to avoid high charge-off levels, or that our allowance for loan losses will be sufficient to cover actual losses.

A customer's ability to repay us can be negatively impacted by increases in their payment obligations to other lenders under mortgage, credit card and other consumer loans. Such changes can result from increases in base lending rates or structured increases in payment obligations, and could reduce the ability of our customers to meet their payment obligations to other lenders and to us. In addition, a customer's ability to repay us can be negatively impacted by the restricted availability of credit to consumers generally, including reduced and closed lines of credit. Customers with insufficient cash flow to fund daily living expenses and lack of access to other sources of credit may be more likely to increase their card usage and ultimately default on their payment obligations to us, resulting in higher credit losses in our portfolio. Our collection operations may not compete effectively to secure more of customers' diminished cash flow than our competitors. In addition, we may not identify customers who are likely to default on their payment obligations to us quickly and reduce our exposure by closing credit lines and restricting authorizations, which could adversely impact our financial condition and results of operations.

Our ability to manage credit risk also may be adversely affected by legal or regulatory changes (such as bankruptcy laws, minimum payment regulations and re-age guidance), competitors' actions and consumer behavior, as well as inadequate collections staffing, techniques, models and performance of vendors such as collection agencies.

We have expanded our marketing of our personal and private student loan products. Also, we significantly increased the size of our student loan portfolio through two acquisitions in the past fiscal year. Our personal and private student

loan portfolios grew to $2.6 billion and $7.3 billion, respectively, at November 30, 2011, compared to $1.9 billion and $1.0 billion, respectively, at November 30, 2010. We have less experience in these areas as compared to our traditional credit card lending business, and there can be no assurance that we will be able to grow these products in accordance with our strategies, manage our credit risk or generate sufficient revenue to cover our expenses in these markets. Our failure to manage our credit risks may materially adversely affect our profitability and our ability to grow these products, limiting our ability to further diversify our business.

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Adverse market conditions or an inability to effectively manage our liquidity risk could negatively impact our ability to meet our liquidity and funding needs, which could materially adversely impact our business operations and overall financial condition.

We must effectively manage the liquidity risk to which we are exposed. We require liquidity in order to meet cash requirements such as day-to-day operating expenses, extensions of credit on our consumer loans and required payments of principal and interest on our borrowings. Our primary sources of liquidity and funding are payments on our credit card loan receivables, deposits, and proceeds from securitization transactions and securities offerings. We may maintain too much liquidity, which can be costly and limit financial flexibility, or we may be too illiquid, which could result in financial distress during a liquidity stress event. Our liquidity portfolio had a balance of approximately $8.5 billion as of November 30, 2011, compared to $10.1 billion as of November 30, 2010. Our total contingent liquidity sources as of November 30, 2011 amounted to $26.2 billion (consisting of $8.5 billion in our liquidity portfolio, $8.4 billion in incremental Federal Reserve discount window capacity, $2.4 billion in a revolving credit facility, and $6.8 billion of undrawn capacity in private securitizations), compared to $22.5 billion at November 30, 2010. Effective December 16, 2011, we terminated the $2.4 billion revolving credit facility due to the availability of other sources of contingent liquidity.

In the event that our current sources of liquidity do not satisfy our needs, we would be required to seek additional financing. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit to the financial services industry, new regulatory restrictions and requirements, and our credit ratings. Disruptions, uncertainty or volatility in the capital, credit or deposit markets, such as the volatility experienced in the capital and credit markets during the financial crisis, may limit our ability to repay or replace maturing liabilities in a timely manner. As such, we may be forced to delay raising funding or be forced to issue or raise funding at undesirable terms and/or costs, which could decrease profitability and significantly reduce financial flexibility. Further, in disorderly financial markets or for other reasons, it may be difficult or impossible to liquidate some of our investments to meet our liquidity needs.

While market conditions have stabilized and, in many cases, improved, there can be no assurance that significant disruption and volatility in the financial markets will not occur in the future. For example, recent concerns regarding U.S. debt and budget matters and the sovereign debt crisis in Europe have caused uncertainty in financial markets. Although the U.S. debt limit was increased, a failure to raise the U.S. debt limit and/or a downgrade of U.S. debt ratings in the future could, in addition to causing economic and financial market disruptions, materially adversely affect our ability to access capital markets on favorable terms and the market value of the U.S. government securities that we hold, as well as have other material adverse effects on the operation of our business and our financial results and condition. Other material adverse effects could include a reduction in our credit ratings resulting from a further decrease in the probability of government support for large financial institutions such as Discover assumed by the rating agencies in their current credit ratings. If we are unable to continue to fund our assets through deposits or access capital markets on favorable terms, or if we experience an increase in our borrowing costs or otherwise fail to manage our liquidity effectively, our liquidity, operating results, financial results and condition may be materially adversely affected.

An inability to accept or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business.

We obtain deposits from consumers either directly or through affinity relationships and through third-party securities brokerage firms that offer our deposits to their customers. We had $26.2 billion in deposits acquired directly or through affinity relationships and $13.3 billion in deposits originated through securities brokerage firms as of November 30, 2011, compared to $20.6 billion and $13.7 billion, respectively, as of November 30, 2010. Competition from other financial services firms that use deposit funding and the rates we offer on our deposit products may affect deposit renewal rates, costs or availability. Changes we make to the rates offered on our deposit products may affect our profitability (through funding costs) and our liquidity (through volumes raised). In addition, our ability to maintain existing or obtain additional deposits may be impacted by factors beyond our control, including perceptions about our financial strength or online banking generally, which could reduce the number of consumers choosing to make deposits with us, third parties continuing or entering into affinity relationships with us, or third-party securities

brokerage firms offering our deposit products.

Our ability to obtain deposit funding and offer competitive interest rates on deposits is also dependent on capital levels of our bank subsidiaries. The Federal Deposit Insurance Act (the "FDIA") prohibits insured banks, including our subsidiary Discover Bank, from accepting brokered deposits (as defined in the FDIA) or offering interest rates on any deposits significantly higher than the prevailing rate in its normal market area or nationally (depending upon where the deposits are solicited), unless (1) it is "well-capitalized" or (2) it is "adequately capitalized" and receives a waiver from the FDIC. A bank that is "adequately capitalized" may not pay an interest rate on any deposit, including direct-to-consumer deposits, in excess of 75 basis points over the national rate published by the FDIC. There are no such restrictions on a bank that is "well-capitalized." As of November 30, 2011, we had brokered deposits (as defined in the FDIA) of $16.9 billion. While Discover Bank met the FDIC's definition of “well-capitalized” as of November 30, 2011, there can be no assurance that it will continue to meet this

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definition. For a comparison of Discover Bank's capital ratios to the "well-capitalized" capital requirements, see Note 19: Capital Adequacy to our consolidated financial statements. Additionally, our regulators can adjust the requirements to be "well-capitalized" at any time and have authority to place limitations on our deposit businesses, including the interest rate we pay on deposits.

If we are unable to securitize our receivables, it may have a material adverse effect on our liquidity, cost of funds and overall financial condition.

Historically, we have used the securitization of credit card receivables, which involves the transfer of receivables to a trust and the issuance by the trust of beneficial interests to third-party investors, as a significant source of funding. Our average level of securitized borrowings from third parties was $13.5 billion for fiscal year 2011 and $17.2 billion for fiscal year 2010. Securitization markets experienced a significant drop in liquidity in 2007 and remain disrupted for some asset classes. The securitization market for credit cards, however, has been re-established, although still not fully at terms or volumes that are similar to pre-2007 levels.

The Reform Act imposes a number of significant changes related to asset-backed securities that may impact our ability and desire to securitize our receivables. For example, the Reform Act nullified Rule 436(g) of the Securities Act of 1933 (the "Securities Act") effective immediately, which subjects the rating agencies to "expert liability" under Section 11 of the Securities Act for misstatements or omissions of material facts in connection with credit ratings contained in registration statements. In response to this measure, the major credit rating agencies issued statements indicating that they would be unwilling to provide issuers with consent to use credit ratings in their registration statements. In order to provide a transition period, the SEC issued a "no-action" letter in July 2010 allowing issuers to omit credit ratings from registration statements until January 24, 2011. In November 2010, the SEC issued a second letter extending this no-action period indefinitely. Failure to ultimately resolve this issue could impact the market for registered asset-backed securities.

The SEC has also proposed revised rules for asset-backed securities offerings that, if adopted, would substantially change the disclosure, reporting and offering process for public and private offerings of asset-backed securities. Recent legislative proposals have affected the timing and final form of these proposals, as the SEC has sought additional comment from market participants. Significant changes to the disclosure requirements or registration process for securitizations could make them more expensive, making securitization less attractive as a funding source.

The ability of issuers of asset-backed securities to obtain necessary credit ratings for their issuances has been based, in part, on qualification under the FDIC's safe harbor rule for assets transferred in securitizations. The FDIC issued a final rule for its securitization safe harbor which requires issuers to comply with a new set of requirements in order to qualify for the safe harbor. Issuances out of our existing credit card securitization trusts are "grandfathered" under the new FDIC final rule. However, preserving this grandfathered status imposes certain restrictions on our trusts. In the event that we would not be able to meet such restrictions, we would need to create new trusts to securitize our receivables. Qualification for the safe harbor with respect to any new trust that we may create to securitize our assets would require us to satisfy the requirements of the FDIC's new final rule.

Our ability to raise funding through the securitization market also depends, in part, on the credit ratings of the securities we issue from our securitization trusts. If we are not able to satisfy rating agency requirements to maintain the ratings of asset-backed securities issued by our trusts, it could limit our ability to access the securitization markets. Additional factors affecting the extent to which we will securitize our credit card receivables in the future include the overall credit quality of our receivables, the costs of securitizing our receivables, and the legal, regulatory, accounting and tax requirements governing securitization transactions. A prolonged inability to securitize our receivables may have a material adverse effect on our liquidity, cost of funds and overall financial condition.

The occurrence of events that result in the early amortization of our existing credit card securitization transactions or an inability to delay the accumulation of principal collections in our credit card securitization trusts would materially adversely affect our liquidity.

Our liquidity would be materially adversely affected by the occurrence of events that could result in the early amortization of our existing credit card securitization transactions. Credit card securitizations are normally structured as "revolving transactions" that do not distribute to securitization investors their share of monthly principal payments on the receivables during the revolving period, and instead use those principal payments to fund the purchase of

replacement receivables. The occurrence of “early amortization events” may result in termination of the revolving periods of our securitization transactions, which would require us to repay the affected outstanding securitized borrowings out of principal collections without regard to the original payment schedule. Our average level of securitized borrowings was $13.5 billion for fiscal year 2011 and $17.2 billion for fiscal year 2010. Early amortization events include, for example, insufficient cash flows

in the securitized pool of receivables to meet contractual requirements (i.e. excess spread less than zero), certain breaches of representations, warranties or covenants in the agreements relating to the securitization, and receivership or insolvency of Discover Bank. For more information on excess spread, see Note 7: Credit Card and Student Loan Securitization Activities to our consolidated financial statements. An early amortization event would negatively impact our liquidity, and require us to rely on alternative funding sources, which may or may not be available at the time.

Our credit card securitization structure includes a requirement that we accumulate principal collections into a restricted account in the amount of scheduled maturities on a pro rata basis over the 12 months prior to a security's maturity date. We have the option under our credit card securitization documents to shorten this accumulation period, subject to the satisfaction of certain conditions, including reaffirmation from each of the rating agencies of the security's required rating. Historically, we have exercised this option to shorten the accumulation period to one month prior to maturity. If we were to determine that the payment rate on the underlying receivables would not support a one-month accumulation period, or if one or more of the rating agencies were to require an accumulation period of longer than one month, we would need to begin accumulating principal cash flows earlier than we have historically. A lengthening of the accumulation period would negatively impact our liquidity, requiring management to implement mitigating measures. During periods of significant maturity levels, absent management actions, the lengthening of the accumulation period could materially adversely affect our financial condition.

A downgrade in the credit ratings of our securities could materially adversely affect our business and financial condition.

We, along with Discover Bank, are regularly evaluated by the ratings agencies, and their ratings for our long-term debt and other securities, including asset-backed securities issued by our securitization trusts, are based on a number of factors, including our financial strength as well as factors that may not be within our control. The credit ratings of the securities issued by our securitization trusts are regularly evaluated by the rating agencies. The ratings of our asset-backed securities are based on a number of factors, including the quality of the underlying receivables and the credit enhancement structure of the trusts. Downgrades in our ratings or those of our trusts could materially adversely affect our cost of funds, access to capital and funding, and overall financial condition. There can be no assurance that we will be able to maintain our current credit ratings or that our credit ratings will not be lowered or withdrawn.

We may not be successful in managing the investments in our liquidity investment portfolio and investment performance may deteriorate due to market fluctuations, which would adversely affect our business and financial condition.

We must effectively manage the risks of the investments in our liquidity investment portfolio, which is comprised of cash and cash equivalents and high quality, liquid investments. Our investments may be adversely affected by market fluctuations including changes in interest rates, prices, credit risk premiums and overall market liquidity. Also, investments backed by collateral could be adversely impacted by changes in the value of the underlying collateral. In addition, continued poor economic conditions may cause certain of the obligors, counterparties and underlying collateral on our investments to incur losses of their own or default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons, thereby increasing our credit risk exposure to these investments. These risks could result in a decrease in the value of our investments, which could negatively impact our financial condition. Further, in an effort to increase the rate of return on our investment portfolio, we may choose new investments, which may result in greater fluctuations in market value. While we expect these investments to be readily convertible into cash and do not believe they present a material increase to our risk profile or will have a material impact on our risk-based capital ratios, they are subject to certain market fluctuations that may reduce the ability to fully convert them into cash.

Changes in the level of interest rates could materially adversely affect our earnings.

Changes in interest rates cause our interest expense to increase or decrease, as certain of our debt instruments carry interest rates that fluctuate with market benchmarks. If we are unable to pass any higher cost of funds to our customers, the increase in interest expense could materially reduce earnings. Some of our consumer loan receivables bear interest at a fixed rate or do not earn interest, and we may not be able to increase the rate on those loans to mitigate any higher cost of funds. At the same time, our variable rate loan receivables, which are based on the prime

market benchmark rate, may not change at the same rate as our floating rate borrowings or may be subject to a cap, subjecting us to basis point risk. The majority of our floating rate borrowings are asset securitizations, which are generally based on the 1-month LIBOR rate. If the prime rate were to decrease without a decrease in the 1-month LIBOR rate, our earnings would be negatively impacted. In addition to asset securitizations, we also utilize deposits as a significant source of funds. Our interest costs associated with existing certificates of deposit are fixed and, therefore, we cannot decrease the rate we pay on these deposits to mitigate any higher cost of funds. New deposit issuances are subject to fluctuations in interest rates.

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Interest rates may also adversely impact our delinquency and charge-off rates. Many consumer lending products bear interest rates that fluctuate with certain base lending rates published in the market, such as the prime rate and LIBOR. As a result, higher interest rates often lead to higher payment requirements by consumers under obligations to us and other lenders, which may reduce their ability to remain current on their obligations to us and thereby lead to loan delinquencies and additions to our loan loss provision, which could materially adversely affect our earnings.
We regularly monitor interest rates and have entered into interest rate derivative agreements in an effort to manage our interest rate risk exposure. Changes in market assumptions regarding future interest rates could significantly impact the valuation of our derivative instruments and, accordingly, impact our financial position and results of operations. If our hedging activities are not appropriately monitored or executed, these activities may not effectively mitigate our interest rate sensitivity or have the desired impact on our results of operations or financial condition. For information related to interest rate risk sensitivities, see "-Quantitative and Qualitative Disclosures About Market Risk."
We may be limited in our ability to pay dividends and repurchase our common stock.

We increased our quarterly common stock dividend from $0.02 per share to $0.06 per share in the second quarter of 2011 and then to $0.10 per share in the first quarter of 2012. In addition, we approved a new two-year $1.0 billion share repurchase program in June 2011, and repurchased 18 million shares, or approximately 3%, of our common stock, for $425 million during the remainder of the 2011 fiscal year. The declaration and payment of future dividends, as well as the amount thereof, are subject to the discretion of our Board of Directors. The amount and size of any future dividends and share repurchases will depend upon our results of operations, financial condition, capital levels, cash requirements, future prospects and other factors. In addition, banking laws and regulations and our banking regulators may limit our ability to pay dividends and make share repurchases. For example, our ability to make capital distributions, including our ability to pay dividends or repurchase shares of our common stock, is subject to the Federal Reserve's review and non-objection of our annual capital plan. In certain circumstances, we will not be able to make a capital distribution unless the Federal Reserve has approved such distribution. Further, current or future regulatory initiatives may require us to hold more capital in the future.

For additional information regarding capital, dividends and share repurchases, see "Business - Supervision and Regulation - Capital, Dividends and Share Repurchases," "Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities," "Management's Discussion and Analysis of Financial Condition and Results of Operations - Regulatory Environment and Developments - Capital and Liquidity," "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Capital" and Note 19: Capital Adequacy to our consolidated financial statements. There can be no assurance that we will declare and pay any dividends or repurchase any shares of our common stock in the future.
If our security systems, or those of merchants, merchant acquirers or other third parties containing information about customers, are compromised, we may be subject to liability and damage to our reputation.
Our security protection measures or the security protections of third parties participating in our networks may not be sufficient to protect the confidentiality of information relating to customers or transactions processed on our networks. Customer data also may be stored on systems of third-party service providers and merchants whose security protections measures may not be adequate. Third-party carriers regularly transport customer data, and may lose sensitive customer information. Unauthorized access to our networks or any of our other information systems potentially could jeopardize the security of confidential information stored in our computer systems or transmitted by our customers or others. As we increase acceptance of the Discover card internationally and expand our suite of direct banking products, we may experience additional risks related to security systems. If our security systems or those of merchants, processors or other third-party service providers are compromised such that this confidential information is disclosed to unauthorized parties, we may be subject to liability. For example, in the event of a security breach, we may incur losses related to fraudulent use of cards issued by us as well as the operational costs associated with reissuing cards. Although we take preventive measures to address these factors, such measures are costly and may become more costly in the future. Moreover, these measures may not protect us from liability, which may not be adequately covered by insurance, or from damage to our reputation.

We may be unable to increase or sustain Discover card usage, which could impair growth in, or lead to diminishing, average balances and total revenue.

A key element of our business strategy is to increase the usage of the Discover card by our customers, including making it their primary card, and thereby increase our revenue from transaction and service fees and interest income. However, our customers' use and payment patterns may change because of social, legal and economic factors, and customers may decide to use debit cards or other payment products instead of credit cards, not to increase card usage, or to pay the balances within the grace period to avoid finance charges. We face challenges from competing card products in our attempts to increase credit card usage by our existing customers. Our ability to increase card usage also is dependent on customer satisfaction, which may be

adversely affected by factors outside of our control, including competitors' actions and legislative/regulatory changes. The CARD Act limits pricing changes that may impact an account throughout its lifecycle, which may reduce our capability to offer lower price promotions to drive account usage and customer engagement. As part of our strategy to increase usage, we have been increasing the number of merchants who accept cards issued on the Discover Network. If we are unable to continue increasing merchant acceptance or fail to improve awareness of existing merchant acceptance of our cards, our ability to grow usage of Discover cards may be hampered. As a result of these factors, we may be unable to increase or sustain credit card usage, which could impair growth in or lead to diminishing average balances and total revenue.

Our transaction volume is concentrated among large merchants, and a reduction in the number of, or rates paid by, large merchants that accept cards on the Discover Network or PULSE network could materially adversely affect our business, financial condition, results of operations and cash flows.

Discover card transaction volume was concentrated among our top 100 merchants in 2011, with our largest merchant accounting for approximately 8% of that transaction volume. Transaction volume on the PULSE network was also concentrated among the top 100 merchants in 2011, with our largest merchant accounting for approximately 13% of PULSE transaction volume. These merchants could seek to negotiate better pricing or other financial incentives by continuing to participate in the Discover Network and/or PULSE network only on the condition that we change the terms of their economic participation. Loss of acceptance at our largest merchants would decrease transaction volume, negatively impact our brand, and could cause customer attrition. At the same time, we are subject to pricing pressure from third-party issuers, who generally have a greater ability than merchants to negotiate higher interchange fees. In addition, some of our merchants, primarily our remaining small and mid-size merchants, are not contractually committed to us for any period of time and may cease to participate in the Discover Network at any time on short notice.

Actual and perceived limitations on acceptance of credit cards issued on the Discover Network or debit cards issued on the PULSE network could adversely affect the use of Discover cards by existing customers, the attractiveness of the Discover card to prospective new customers and the interest of other financial institutions in issuing cards on the Discover Network or the PULSE network. We may have difficulty attracting and retaining third-party issuers if we are unable to add and retain acquirers or merchants who accept cards issued on the Discover or PULSE networks. As a result of these factors, a reduction in the number of, or rates paid by, our merchants could materially adversely affect our business, financial condition, results of operations and cash flows.

We may be unable to grow earnings if we are unable to increase or maintain the number of small and mid-size merchants that participate in the Discover Network.

In order to expand our merchant acceptance among small and mid-size merchants, we have been entering into agreements with and have been using third-party acquirers and processors to add merchants to the Discover Network and accept and process payments for these merchants on an integrated basis with Visa and MasterCard payments. This strategy could result in decreased revenues, higher expenses, degraded service and signage placement levels and retaliatory responses from competitors. There can be no assurance that the use of third-party acquirers and processors will continue to increase merchant acceptance among small or mid-size merchants, or that such third-party acquirers will continue to work with us. If we are unable to continue to increase or maintain small and mid-size merchant acceptance, our competitive position and our ability to grow earnings could be adversely affected.

Our business, financial condition and results of operations may be adversely affected by the increasing focus of merchants on the fees charged by credit card and debit card networks.

Merchant acceptance and fees are critical to the success of both our card issuing and payment processing businesses. Merchants are concerned with the fees charged by credit card and debit card networks. They seek to negotiate better pricing or other financial incentives as a condition to continued participation in the Discover Network and PULSE network. During the past few years, merchants and their trade groups have filed numerous lawsuits against Visa, MasterCard, American Express and their card-issuing banks, claiming that their practices toward merchants, including interchange fees, violate federal antitrust laws. There can be no assurance that they will not in the future bring legal proceedings against other credit card and debit card issuers and networks, including us. Merchants also may promote forms of payment with lower fees, such as ACH-based payments, or seek to impose surcharges at the point of sale for

use of credit or debit cards. Merchant groups have also promoted federal and state legislation that would restrict issuer practices or enhance the ability of merchants, individually or collectively, to negotiate more favorable fees. The heightened focus by merchants on the fees charged by credit card and debit card networks, together with the Reform Act and recent U.S. Department of Justice settlements with Visa and MasterCard, which would allow merchants to encourage customers to use other payment methods or cards, could lead to reduced transactions on, or merchant acceptance of, Discover Network or PULSE network cards or reduced fees, either of which could adversely affect our business, financial condition and results of operations.

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Political, economic or other instability in a country or geographic region, or other unforeseen or catastrophic events, could adversely affect our international business activities and reduce our revenue.
Natural disasters or other catastrophic events, including terrorist attacks, may have a negative effect on our business and infrastructure, including our information technology systems. Our Diners Club network, concentrated on primarily serving the global travel industry, could be adversely affected by international conditions that may result in a decline in consumer or business travel activity. Armed conflict, public health emergencies, natural disasters or terrorism may have a significant negative effect on travel activity and related revenue. Although a regionalized event or condition may primarily affect one of our network participants, it may also affect our overall network activity and our resulting revenue. Overall network transaction activity may decline as a result of concerns about safety or disease or may be limited because of economic conditions that result in spending on travel to decline. The impact of such events and other catastrophes on the overall economy may also adversely affect our financial condition or results of operations.
Fraudulent activity associated with our products or our networks could cause our brands to suffer reputational damage, the use of our products to decrease and our fraud losses to be materially adversely affected.
We are subject to the risk of fraudulent activity associated with merchants, customers and other third parties handling customer information. Our fraud losses were $72 million and $44 million for the years ended November 30, 2011 and 2010, respectively. Credit and debit card fraud, identity theft and related crimes are prevalent and perpetrators are growing ever more sophisticated. Our resources and fraud prevention tools may be insufficient to accurately predict and prevent fraud. The risk of fraud is expected to increase as we expand the acceptance of the Discover card internationally and expand our direct-to-consumer deposit business. Our financial condition, the level of our fraud charge-offs and other results of operations could be materially adversely affected if fraudulent activity were to significantly increase. High profile fraudulent activity could negatively impact our brand and reputation. In addition, significant increases in fraudulent activity could lead to regulatory intervention (such as mandatory card reissuance) and reputational and financial damage to our brands, which could negatively impact the use of our cards and networks and thereby have a material adverse effect on our business. Further, fraudulent activity may result in lower license fee revenue from our Diners Club licensees.
The financial services and payment services industries are rapidly evolving, and we may be unsuccessful in introducing new products or services on a large scale in response to this evolution.
The financial services and payment services industries experience constant and significant technological changes, such as continuing development of technologies in the areas of smart cards, radio frequency and proximity payment devices, electronic commerce and mobile commerce, among others. The effect of technological changes on our business is unpredictable. We depend, in part, on third parties for the development of and access to new technologies. We expect that new services and technologies relating to the payments business will continue to appear in the market, and these new services and technologies may be superior to, or render obsolete, the technologies that we currently use in our products and services. As a result, our future success may be dependent on our ability to identify and adapt to technological changes and evolving industry standards and to provide payment solutions for our customers, merchants and financial institution customers.
Difficulties or delays in the development, production, testing and marketing of new products or services may be caused by a number of factors including, among other things, operational, capital and regulatory constraints. The occurrence of such difficulties may affect the success of our products or services, and developing unsuccessful products and services could result in financial losses, as well as decreased capital availability. In addition, the new products and services offered may not be attractive to consumers and merchant and financial institution customers. Also, success of a new product or service may depend upon our ability to deliver it on a large scale, which may require a significant capital investment that we may not be in a position to make. If we are unable to successfully introduce and maintain new income-generating products and services, it may impact our ability to compete effectively and materially adversely affect our business and earnings.

We rely on third parties to deliver services. If we face difficulties managing our relationships with third-party service providers, our revenue or results of operations could be materially adversely affected.

We depend on third-party service providers for many aspects of the operation of our business. We depend on third parties for the timely transmission of information across our data transportation network and for other telecommunications, processing, remittance and technology-related services in connection with our direct banking and payment services businesses. If a service provider fails to provide the services that we require or expect, or fails to meet contractual requirements, such as service levels or compliance with applicable laws, the failure could negatively impact our business by adversely affecting our ability to process customers' transactions in a timely and accurate manner, otherwise hampering our ability to serve our customers, or subjecting us to litigation and regulatory risk. Such a failure could adversely affect the perception of the reliability of our networks and services and the quality of our brands, and could materially adversely affect our revenues and/or our results of operations.

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We rely on technology to deliver services. If key technology platforms become obsolete, or if we experience disruptions, including difficulties in our ability to process transactions, our revenue or results of operations could be materially adversely affected.

Our ability to deliver services to our customers and run our business in compliance with applicable laws and regulations may be affected by the functionality of our technology systems. The implementation of technology changes and upgrades to maintain current and integrated systems may, at least temporarily, cause disruptions to our business, including, but not limited to, systems interruptions, transaction processing errors and system conversion delays, all of which could have a negative impact on us. In addition, our transaction processing systems and other operational systems may encounter service interruptions at any time due to system or software failure, natural disaster or other reasons. Such services could be disrupted at any of our primary or back-up facilities or our other owned or leased facilities. We also outsource the maintenance and development of our technological functionality in many cases to third parties, who may experience errors or disruptions that could adversely impact us and over which we may have limited control. In addition, there is no assurance that we will be able to sustain our investment in new technology to avoid obsolescence of critical systems and applications. A failure to maintain current technology, systems and facilities or to control third-party risk, could cause disruptions in the operation of our business, which could materially adversely affect our transaction volumes, our revenues and/or our results of operations.

Merchant defaults may adversely affect our business, financial condition, cash flows and results of operations.

As an issuer and merchant acquirer in the United States on the Discover Network, and as a holder of certain merchant agreements internationally for the Diners Club network, we may be contingently liable for certain disputed credit card sales transactions that arise between customers and merchants. If a dispute is resolved in the customer's favor, we will cause a credit or refund of the amount to be issued to the customer and charge back the transaction to the merchant or merchant acquirer. If we are unable to collect this amount from the merchant or merchant acquirer, we will bear the loss for the amount credited or refunded to the customer. Where the purchased product or service is not provided until some later date following the purchase, such as an airline ticket, the likelihood of potential liability increases. For the years ended November 30, 2011 and 2010, we had $1.6 million and $2.3 million, respectively, of losses related to merchant chargebacks.

Our success is dependent, in part, upon our executive officers and other key employees. If we are unable to recruit, retain and motivate key officers and employees to manage our business well, our business could be materially adversely affected.

Our success depends, in large part, on our ability to retain, recruit and motivate key officers and employees to manage our business. Our senior management team has significant industry experience and would be difficult to replace. We believe we are in a critical period of competition in the financial services and payments industry. The market for qualified individuals is highly competitive, and we may not be able to attract and retain qualified personnel or candidates to replace or succeed members of our senior management team or other key personnel. We may be subject to restrictions under future legislation or regulation limiting executive compensation. For example, the federal banking agencies issued guidance on incentive compensation policies at banking organizations and the Reform Act imposes additional disclosures and restrictions on compensation. These restrictions could negatively impact our ability to compete with other companies in recruiting and retaining key personnel and could impact our ability to offer incentives that motivate our key personnel to perform. If we are unable to recruit, retain and motivate key personnel to manage our business well, our business could be materially adversely affected.

Damage to our reputation could damage our business.

Recently, financial services companies have been experiencing increased reputational risk as consumers protest and regulators scrutinize practices of such companies to maintain or increase business and revenues. Maintaining a positive reputation is critical to our attracting and retaining customers, investors and employees. Damage to our reputation can therefore cause significant harm to our business and prospects. Harm to our reputation can arise from numerous sources, including, among others, employee misconduct, litigation or regulatory outcomes, failing to deliver minimum standards of service and quality, compliance failures, and the activities of customers and counterparties. Negative publicity regarding us, whether or not true, may result in customer attrition and other harm to our business prospects.

We may be unsuccessful in promoting and protecting our brands or protecting our other intellectual property, or third parties may allege that we are infringing their intellectual property rights.

The Discover, PULSE and Diners Club brands have substantial economic and goodwill value. Our success is dependent on our ability to promote and protect these brands and our other intellectual property. Our ability to attract and retain customers is highly dependent upon the external perception of our company and brands. Our brands are licensed for use to business partners and network participants, some of whom have contractual obligations to promote and develop our brands. The value of our brands and our overall business success may be adversely affected by actions of our business partners and network participants that diminish the perception of our brands.

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We may not be able to successfully protect our brands and our other intellectual property. If others misappropriate, use or otherwise diminish the value of our intellectual property, our business could be adversely affected. In addition, third parties may allege that our marketing, processes or systems may infringe their intellectual property rights. Given the potential risks and uncertainties of such claims, our business could be adversely affected by having to pay significant monetary damages or licensing fees and we may have to alter our business practices.

Acquisitions or strategic investments that we pursue may not be successful and could disrupt our business, harm our financial condition or reduce our earnings.

We may consider or undertake strategic acquisitions of, or material investments in, businesses, products, portfolios of loans or technologies, such as our recent private student loan acquisitions. We may not be able to identify suitable acquisition or investment candidates, or even if we do identify suitable candidates, they may be difficult to finance, expensive to fund and there is no guarantee that we can obtain any necessary regulatory approvals or complete the transactions on terms that are favorable to us. We generally must receive federal regulatory approvals before we can acquire a bank, bank holding company, deposits or certain assets or businesses. For additional information regarding bank regulatory limitations on acquisitions and investments, see "Business - Supervision and Regulation - Acquisitions and Investments." To the extent we pay the purchase price of any acquisition or investment in cash, it would reduce our cash balances and regulatory capital, which may have an adverse effect on our financial condition; similarly, if the purchase price is paid with our stock, it would be dilutive to our stockholders. In addition, we may assume liabilities associated with a business acquisition or investment, including unrecorded liabilities that are not discovered at the time of the transaction, and the repayment of those liabilities may have an adverse effect on our financial condition.

We may not be able to successfully integrate the personnel, operations, businesses, products, or technologies of an acquisition or investment. Integration may be particularly challenging if we enter into a line of business in which we have limited experience and the business operates in a difficult legal, regulatory or competitive environment. We may find that we do not have adequate operations or expertise to manage the new business. The integration of any acquisition or investment may divert management's time and resources from our core business, which could impair our relationships with our current employees, customers and strategic partners and disrupt our operations. Acquisitions and investments also may not perform to our expectations for various reasons, including the loss of key personnel, customers or vendors. If we fail to integrate acquisitions or investments or realize the expected benefits, we may lose the return on these acquisitions or investments or incur additional transaction costs, and our business and financial condition may be harmed as a result.

Laws, regulations, and supervisory guidance and practices, or the application thereof, may adversely affect our business, financial condition and results of operations.

We must comply with an array of banking and consumer lending laws and regulations in all of the jurisdictions in which we operate. As a bank holding company, we are subject to oversight, regulation and examination by the Federal Reserve, including scrutiny of our risk management program; business strategy, earnings, capital and cash flow; anti-money laundering program; and examination of our non-bank businesses, including Discover Network, PULSE and Diners Club, and their relationships with our banking subsidiaries. Our banking subsidiaries are subject to regulation and regular examinations by the FDIC and the Delaware Bank Commissioner. We are also now subject to regulation and regular examination by the CFPB. To the extent that states enact requirements that differ from federal standards or state officials and courts adopt interpretations of federal consumer laws that differ from those adopted by the CFPB, we may face increased inquiries and enforcement actions from state attorney general offices. In addition, we are subject to regulation by the Federal Trade Commission, state banking regulators and the U.S. Department of Justice, as well as the SEC and New York Stock Exchange in our capacity as a public company. In addition, as our payments business has expanded globally through the acquisition of Diners Club, we are subject to government regulation in countries in which our networks operate or our cards are used, either directly or indirectly through regulation affecting Diners Club network licensees.

From time to time, these regulations and regulatory agencies have required us to alter certain of our operating practices, and may require us to do the same in the future. Our ability to execute our business strategies through acquisitions or the introduction of new products or pricing may be impaired or delayed as a result of regulatory review

or failure to obtain required regulatory approvals. Various federal and state regulators have broad discretion to impose restrictions and requirements on our company, subsidiaries and operations, including restrictions on capital actions such as increasing dividends. U.S. federal laws, such as the CARD Act, and state consumer protection laws and rules, limit the manner and terms on which we may offer and extend credit. We have had class action lawsuits filed against us alleging that we have violated various federal and state laws, such as the Truth in Lending Act and the Telephone Consumer Protection Act. We are subject to capital, funding and liquidity requirements prescribed by statutes, regulations and orders, including initiatives under the Reform Act and Basel III that will require us to hold higher levels of capital to support our businesses. We are also subject to the requirements of accounting standard setters and those who interpret the accounting standards (such as the FASB, the SEC, banking regulators and our

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independent registered public accounting firm), who may add new requirements or change their interpretations on how standards should be applied, potentially materially impacting how we record and report our financial condition and results of operations. We are also subject to FDIC increases in deposit insurance assessments or additional special assessments, which could adversely affect our results of operations and financial condition. The Reform Act has removed the statutory cap for the reserve ratio, leaving the FDIC free to set a cap in the future.

In addition, regulation of the payments industry, including regulation applicable to us, merchant acquirers and our other business partners and customers, has expanded significantly in recent years. The Reform Act includes provisions governing debit and credit card network businesses. In addition, various U.S. federal and state regulatory agencies and state legislatures have considered new legislation or regulations relating to restrictions regarding fees and interchange charged to merchants and acquirers, as well as additional charges for premium payment card transactions, and other restrictions related to identity theft, privacy, data security and marketing that could have a direct effect on us and our merchant and financial institution customers. In addition, the payments industry is the subject of increasing global regulatory focus, which may result in costly new compliance burdens being imposed on us and our customers and lead to increased costs and decreased payments volume and revenues. We, our Diners Club licensees and Diners Club customers are subject to regulations that affect the payments industry in many countries in which our cards are used.

Failure to comply with laws and regulations could lead to adverse consequences such as financial, structural, reputational and operational penalties, including receivership, litigation exposure and fines. Legislative and regulatory changes could impact the profitability of our business activities, require us to limit or change our business practices, and expose us to additional costs (including increased compliance costs). Significant changes in laws and regulations may have a more adverse effect on our results of operations than on the results of our larger, more diversified competitors. For additional recent legislative and regulatory developments that may affect our business, see “Management's Discussion and Analysis of Financial Condition and Results of Operations - Regulatory Environment and Developments.”

Current and proposed regulation addressing consumer privacy and data use and security could inhibit the number of payment cards issued and increase our costs.

Regulatory pronouncements relating to consumer privacy, data use and security affect our business. In the United States, we are subject to a number of laws concerning consumer privacy and data use and security. We are subject to the Federal Trade Commission's and the banking regulators' information safeguard rules under the Gramm-Leach-Bliley Act. The rules require that financial institutions (including us) develop, implement and maintain a written, comprehensive information security program containing safeguards that are appropriate to the financial institution's size and complexity, the nature and scope of the financial institution's activities, and the sensitivity of any customer information at issue. The United States has experienced a heightened legislative and regulatory focus on privacy, data security, including requiring consumer notification in the event of a data breach. In addition, most states have enacted security breach legislation requiring varying levels of consumer notification in the event of certain types of security breaches, and several other states are considering similar legislation.

Regulation of privacy, data use and security may cause an increase in the costs to issue payment cards and/or may decrease the number of our cards that we or third parties issue. New regulations in these areas may also increase our costs to comply with such regulations, which could negatively impact our earnings. In addition, failure to comply with the privacy and data use and security laws and regulations to which we are subject, including by reason of inadvertent disclosure of confidential information, could result in fines, sanctions, penalties or other adverse consequences and loss of consumer confidence, which could materially adversely affect our results of operations, overall business and reputation.

Litigation and regulatory actions could subject us to significant fines, penalties and/or requirements resulting in increased expenses.

Businesses in the credit card industry have historically been subject to significant legal actions, including class action lawsuits and commercial, shareholder and patent litigation. Many of these actions have included claims for substantial compensatory, statutory or punitive damages. For example, we currently have a class action lawsuit pending against us alleging violations of the Telephone Consumer Protection Act, which prohibits contacting customers on their cellular telephones without their express consent, and provides for significant statutory damages ($500 for each

violation and $1,500 for willful violations). While we have historically relied on our arbitration clause in agreements with customers to limit our exposure to consumer class action litigation, there can be no assurance that we will continue to be successful in enforcing our arbitration clause in the future. Legal challenges to the enforceability of these clauses have led most card issuers and may cause us to discontinue their use. There are bills pending in Congress to directly or indirectly prohibit the use of pre-dispute arbitration clauses and the Reform Act authorized the CFPB to limit or ban pre-dispute arbitration clauses. Further, we are involved in pending legal actions challenging our arbitration clause. In addition, we may be involved in various actions or proceedings brought by governmental regulatory agencies in the event of noncompliance with laws or regulations, which could harm our reputation,

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require us to limit our business activities or subject us to significant fines, penalties or other requirements, resulting in increased expenses. See Note 21: Litigation and Regulatory Matters for information regarding current matters.

Special Note Regarding Forward-Looking Statements

This annual report on Form 10-K and materials we have filed or will file with the SEC (as well as information included in our other written or oral statements) contain or will contain certain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Actual outcomes and results may differ materially from those expressed in, or implied by, our forward-looking statements. Words such as “expects,” “anticipates,” “believes,” “estimates” and other similar expressions or future or conditional verbs such as “will,” “should,” “would” and “could” are intended to identify such forward-looking statements. You should not rely solely on the forward-looking statements and should consider all uncertainties and risks throughout this annual report on Form 10-K, including those described under “Risk Factors.” The statements are only as of the date they are made, and we undertake no obligation to update any forward-looking statement.

Possible events or factors that could cause results or performance to differ materially from those expressed in our forward-looking statements include the following:

- changes in economic variables, such as the availability of consumer credit, the housing market, energy costs, the number and size of personal bankruptcy filings, the rate of unemployment, the levels of consumer confidence and consumer debt, and investor sentiment;
- the impact of current, pending and future legislation, regulation, supervisory guidance, and regulatory and legal actions, including those related to financial regulatory reform, consumer financial services practices, and funding, capital and liquidity;
- the actions and initiatives of current and potential competitors;
- our ability to manage our expenses;
- our ability to successfully achieve full card acceptance across our networks and maintain relationships with network participants;
- our ability to sustain and grow our private student loan portfolio;
- our ability to manage our credit risk, market risk, liquidity risk, operational risk, legal and compliance risk, and strategic risk;
- the availability and cost of funding and capital;
- access to deposit, securitization, equity, debt and credit markets;
- the impact of rating agency actions;
- the level and volatility of equity prices, commodity prices and interest rates, currency values, investments, other market fluctuations and other market indices;
- losses in our investment portfolio;
- limits on our ability to pay dividends and repurchase our common stock;
- fraudulent activities or material security breaches of key systems;
- our ability to increase or sustain Discover card usage or attract new customers;
- our ability to attract new merchants and maintain relationships with current merchants;
- the effect of political, economic and market conditions, geopolitical events and unforeseen or catastrophic events;
- our ability to introduce new products or services;
- our ability to manage our relationships with third-party vendors;
- our ability to maintain current technology and integrate new and acquired systems;
- our ability to collect amounts for disputed transactions from merchants and merchant acquirers;
- our ability to attract and retain employees;
- our ability to protect our reputation and our intellectual property;
- difficulty obtaining regulatory approval for, financing, closing, transitioning, integrating or managing the expenses of acquisitions of or investments in new businesses, products or technologies; and
- new lawsuits, investigations or similar matters or unanticipated developments related to current matters.

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We routinely evaluate and may pursue acquisitions of or investments in businesses, products, technologies, loan portfolios or deposits, which may involve payment in cash or our debt or equity securities.

The foregoing review of important factors should not be construed as exclusive and should be read in conjunction with the other cautionary statements that are included in this annual report on Form 10-K. These factors expressly qualify all subsequent oral and written forward-looking statements attributable to us or persons acting on our behalf. Except for any ongoing obligations to disclose material information as required under U.S. federal securities laws, we do not have any intention or obligation to update forward-looking statements after we distribute this annual report on Form 10-K, whether as a result of new information, future developments or otherwise.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We have nine principal properties located in eight states in the United States. As of January 20, 2012, we owned four principal properties, which included our corporate headquarters, two call centers and a processing center, and we leased five principal properties, which included two call centers, our PULSE headquarters, and two SLC offices. The call centers, processing center and SLC offices largely support our Direct Banking segment, the PULSE headquarters is used by our Payment Services segment, and our corporate headquarters is used by both our Direct Banking and Payment Services segments. Both our call centers and processing center are operating at and being utilized to a reasonable capacity and we believe our principal facilities are both suitable and adequate to meet our current and projected needs. We also have nine leased offices, seven of which are located outside the United States, that are used to support our Diners Club operations, and one leased office that supports our Direct Banking segment.

Item 3. Legal Proceedings

For a description of legal proceedings, see Note 21: Litigation and Regulatory Matters to our consolidated financial statements.

Item 4. (Removed and Reserved)

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PART II.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Common Stock Market Prices and Dividends

Our common stock began trading “regular way” on the New York Stock Exchange ("NYSE") (ticker symbol DFS) on July 2, 2007. The approximate number of record holders of our common stock as of January 20, 2012 was 76,673. The following table sets forth the quarterly high and low sales prices of a share of our common stock as reported by the NYSE and the cash dividends we declared per share of our common stock during the quarter indicated:

Quarter Ended:	Stock Price		Cash Dividends Declared
2010	High	Low	
February 28	$16.78	$12.58	$0.02
May 31	$16.59	$12.61	$0.02
August 31	$15.78	$12.11	$0.02
November 30	$19.16	$14.65	$0.02
2011			
February 28	$22.04	$17.86	$0.02
May 31	$25.76	$20.96	$0.06
August 31	$27.92	$20.51	$0.06
November 30	$27.32	$21.44	$0.06

In the second quarter of 2011, we increased our quarterly common stock dividend from $.02 per share to $.06 per share and maintained a $.06 per share dividend in each of the third and fourth quarters of 2011. In the first quarter of 2012, we increased our dividend to $.10 per share. Although we expect to continue our policy of paying regular cash dividends, we cannot assure that we will do so in the future. For more information, including conditions and limits on our ability to pay dividends, see "Business - Supervision and Regulation - Capital, Dividends and Share Repurchases," "Risk Factors - We may be limited in our ability to pay dividends and repurchase our common stock," "Management's Discussion and Analysis of Financial Condition and Results of Operations - Regulatory Environment and Developments - Capital and Liquidity," "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Capital" and Note 19: Capital Adequacy to our consolidated financial statements.

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Issuer Purchases of Equity Securities

The table below sets forth information regarding purchases of our common stock related to our share repurchase program and employee transactions that were made by us or on our behalf during the three months ended November 30, 2011.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program[1]	Maximum Dollar Value of Shares that may yet be purchased under the Plan or Programs [1]
September 1- 30, 2011				
Repurchase program [1]	3,216,673	$24.09	3,216,673	$724,840,266
Employee transactions [2]	658	$25.14	N/A	N/A
October 1 - 31, 2011				
Repurchase program [1]	6,421,601	$23.28	6,421,601	$575,325,815
Employee transactions [2]	—	$—	N/A	N/A
November 1 - 30, 2011				
Repurchase program [1]	—	$—	—	$575,325,815
Employee transactions [2]	321	$24.61	N/A	N/A
Total				
Repurchase program [1]	9,638,274	$23.55	9,638,274	$575,325,815
Employee transactions [2]	979	$24.97	N/A	N/A

(1) On June 15, 2011, our board of directors approved and we announced a share repurchase program authorizing the repurchase of up to $1 billion of our outstanding shares of common stock. This share repurchase program expires on June 14, 2013 and may be terminated at any time.

(2) Reflects shares withheld (under the terms of grants under employee stock compensation plans) to offset tax withholding obligations that occur upon the delivery of outstanding shares underlying restricted stock units or upon the exercise of stock options.

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Stock Performance Graph

The following graph compares the cumulative total stockholder return (rounded to the nearest whole dollar) of our common stock, the S&P 500 Stock Index and the S&P 500 Financials Index for the period from July 2, 2007 through November 30, 2011. The graph assumes an initial investment of $100 on July 2, 2007, the date we began “regular way” trading on the NYSE following our spin-off. The cumulative returns include stock price appreciation and assume full reinvestment of dividends. This graph does not forecast future performance of our common stock.

	Discover Financial Services	S&P 500 Index	S&P 500 Financials Index
July 2, 2007	$100.00	$100.00	$100.00
November 30, 2007	$63.14	$97.48	$84.67
November 30, 2008	$36.89	$58.99	$34.60
November 30, 2009	$56.63	$72.11	$40.11
November 30, 2010	$67.31	$77.70	$39.52
November 30, 2011	$88.26	$82.07	$35.11

Item 6. Selected Financial Data

The following table presents our selected financial data and operating statistics. The statement of income data for each of the years in the three-year period ended November 30, 2011 and the statement of financial condition data as of November 30, 2011 and 2010 have been derived from our audited consolidated financial statements included elsewhere in this annual report on Form 10-K. The statement of financial condition data as of November 30, 2009 and 2008, and the statement of income data for the year ended November 30, 2008 have been derived from audited consolidated financial statements not included elsewhere in this annual report on Form 10-K.

The selected financial data shown below for the year ended November 30, 2010 reflects a change in accounting principle as a result of the consolidation of the securitization trusts, which is more fully described in Note 2: Change in Accounting Principle to our consolidated financial statements. Selected financial data shown below for historical periods prior to December 1, 2009 have not been retrospectively adjusted to reflect the change in accounting principle and therefore continue to reflect the accounting standards that were applicable during those historical periods.

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Discover Financial Services
Selected Financial Data

	For the Years Ended November 30,				
	2011[1]	2010[1]	2009	2008	2007
	(dollars in thousands, except per share amounts)				
Statement of Income Data:					
Interest income	$6,345,139	$6,146,218	$3,145,080	$2,692,563	$2,584,402
Interest expense	1,484,552	1,582,988	1,251,284	1,288,004	1,223,270
Net interest income	4,860,587	4,563,230	1,893,796	1,404,559	1,361,132
Other income[2]	2,205,174	2,094,999	4,840,595	4,264,458	3,376,682
Revenue net of interest expense	7,065,761	6,658,229	6,734,391	5,669,017	4,737,814
Provision for loan losses	1,013,350	3,206,705	2,362,405	1,595,615	733,887
Other expense	2,541,167	2,182,665	2,251,088	2,415,797	2,478,214
Income before income tax expense	3,511,244	1,268,859	2,120,898	1,657,605	1,525,713
Income tax expense	1,284,536	504,071	844,713	594,692	561,514
Income from continuing operations	2,226,708	764,788	1,276,185	1,062,913	964,199
Loss from discontinued operations, net of tax[3]	—	—	—	(135,163)	(375,569)
Net income[2]	$2,226,708	$764,788	$1,276,185	$927,750	$588,630
Net income allocated to common stockholders	$2,201,759	$667,938	$1,206,965	$910,510	$572,480
Statement of Financial Condition Data (as of):					
Loan receivables[4]	$57,336,935	$48,836,413	$23,625,084	$25,216,611	$20,831,117
Total assets	$68,783,937	$60,784,968	$46,020,987	$39,892,382	$37,376,105
Total stockholders' equity	$8,242,211	$6,456,846	$8,435,547	$5,915,823	$5,599,422
Allowance for loan losses	$2,205,196	$3,304,118	$1,757,899	$1,374,585	$759,925
Long-term borrowings	$18,287,178	$17,705,728	$2,428,101	$1,735,383	$2,134,093
Per Share of Common Stock:					
Basic EPS from continuing operations	$4.06	$1.23	$2.39	$2.18	$1.99
Diluted EPS from continuing operations	$4.06	$1.22	$2.38	$2.18	$1.98
Weighted average shares outstanding (000's)[5]	541,813	544,058	504,540	479,335	477,328
Weighted average shares outstanding (fully diluted) (000's)[5]	542,626	548,760	507,907	479,357	477,988
Cash dividends declared	$0.20	$0.08	$0.12	$0.24	$0.06
Dividend payout ratio	4.92%	6.52%	5.02%	11.01%	3.02%
Ratios:					
Return on average equity	30%	12%	17%	16%	10%
Return on average assets	3%	1%	3%	3%	2%
Average stockholders' equity to average total assets	12%	11%	18%	15%	15%

(1)

Amounts as of and for the years ended November 30, 2011 and 2010 include securitized loans as a result of the consolidation of the securitization trusts related to a change in accounting principle on December 1, 2009. Amounts prior to December 1, 2009 do not include securitized loans.

(2) The years ended November 30, 2009 and 2008 include $1.9 billion pretax ($1.2 billion after tax) and $0.9 billion pretax ($0.5 billion after tax), respectively, of income related to the Visa and MasterCard antitrust litigation settlement, which is included in our Direct Banking segment.

(3) 2007 includes a $391 million pretax ($279 million after tax) non-cash impairment charge to write-down the intangible assets and goodwill of the Goldfish business, which was sold on March 31, 2008.

(4) 2011 includes $3.1 billion of student loan receivables acquired with the SLC acquisition and $2.4 billion of student loan receivables acquired from Citibank, N.A.

(5) On June 30, 2007, Morgan Stanley distributed to Morgan Stanley stockholders one share of our common stock for every two shares of Morgan Stanley common stock held on June 18, 2007. As a result, on July 2, 2007, we had 477,235,927 shares of common stock outstanding and this share amount is being utilized for the calculation of basic earnings per share (“EPS”) for all periods presented prior to the date of the spin-off. For all periods prior to the spin-off date, the same number of shares is being used for diluted EPS as for basic EPS as none of our common stock was traded prior to July 2, 2007 and none of our equity awards were outstanding for the prior periods.

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The loan receivables information shown below is provided on both a GAAP basis and a "non-GAAP as-adjusted" basis. The non-GAAP as-adjusted basis assumes that the trusts used in our securitization activities were consolidated into our financial results and excludes from results income received in connection with the antitrust litigation settlement in 2009 and 2008. For an explanation as to why management believes that the non-GAAP as-adjusted numbers are useful to investors and for a reconciliation of these numbers, see "Management's Discussion and Analysis of Financial Condition and Results of Operations - Reconciliations of GAAP to Non-GAAP As-Adjusted Data."

	For the Years Ended November 30,				
	2011(1)	2010(1)	2009	2008	2007
		(dollars in thousands)			
Selected Statistics:					
Total Loan Receivables					
GAAP information:					
Loan receivables	$57,336,935	$48,836,413	$23,625,084	$25,216,611	$20,831,117
Average loan receivables	$52,942,622	$49,909,187	$26,552,574	$21,348,493	$19,947,784
Interest yield	11.85%	12.20%	11.31%	10.89%	10.73%
Net principal charge-off rate	3.99%	7.57%	7.45%	4.59%	3.40%
Delinquency rate (over 30 days)	2.30%	3.89%	4.92%	4.35%	3.26%
Delinquency rate (over 90 days)	1.14%	2.04%	2.58%	2.06%	1.51%
Non-GAAP as-adjusted information:					
Loan receivables - Non-GAAP as-adjusted	N/A	N/A	$50,854,146	$51,095,278	$48,180,436
Average loan receivables - Non-GAAP as-adjusted	N/A	N/A	$51,130,117	$49,011,148	$46,913,474
Interest yield - Non-GAAP as adjusted	N/A	N/A	12.40%	12.59%	12.65%
Net principal charge-off rate - Non-GAAP as-adjusted	N/A	N/A	7.77%	5.01%	3.83%
Delinquency rate (over 30 days) - Non-GAAP as-adjusted	N/A	N/A	5.31%	4.56%	3.58%
Delinquency rate (over 90 days) - Non-GAAP as-adjusted	N/A	N/A	2.78%	2.17%	1.67%
Total Credit Card Loan Receivables					
GAAP information					
Credit card loan receivables	$46,638,625	$45,156,994	$20,230,302	$23,814,307	$20,579,923
Average credit card loan receivables	$45,204,829	$45,616,791	$24,266,782	$20,566,864	$19,845,880
Interest yield	12.51%	12.79%	11.69%	10.92%	10.75%
Net principal charge-off rate	4.50%	8.08%	7.87%	4.73%	3.41%
Delinquency rate (over 30 days)	2.39%	4.06%	5.52%	4.55%	3.28%
Delinquency rate (over 90 days)	1.20%	2.12%	2.92%	2.16%	1.53%
Non-GAAP as-adjusted information:					
Credit card loan receivables - Non-GAAP as-adjusted	N/A	N/A	$47,459,364	$49,692,974	$47,929,242
Average credit card loan receivables - Non-GAAP as-adjusted	N/A	N/A	$48,844,325	$48,229,519	$46,811,570
Interest yield - Non-GAAP as-adjusted	N/A	N/A	12.63%	12.63%	12.66%
Net principal charge-off rate - Non-GAAP as-adjusted	N/A	N/A	8.00%	5.07%	3.84%
Delinquency rate (over 30 days) - Non-GAAP as-adjusted	N/A	N/A	5.60%	4.66%	3.59%
	N/A	N/A	2.94%	2.22%	1.68%

Delinquency rate (over 90 days) - Non-GAAP as-adjusted					
Personal loans					
GAAP information					
Personal loan receivables	$2,648,051	$1,877,633	$1,394,379	$1,028,093	$165,529
Average personal loan receivables	$2,228,226	$1,592,661	$1,223,841	$620,446	$25,335
Interest yield	11.94%	11.41%	11.38%	11.57%	10.81%
Net principal charge-off rate	3.02%	5.72%	5.53%	1.19%	3.43%
Delinquency rate (over 30 days)	0.87%	1.57%	2.17%	1.06%	0.28%
Delinquency rate (over 90 days)	0.28%	0.57%	0.71%	0.25%	0.07%
Private Student Loans (excluding PCI)					
GAAP information					
Private student loan receivables	$2,069,001	$999,322	$579,679	$132,180	$8,440
Average private student loan receivables	$1,637,260	$826,807	$363,985	$42,951	$1,797
Interest yield	7.04%	5.75%	4.73%	5.85%	6.07%
Net principal charge-off rate	0.48%	0.33%	0.05%	0.01%	—%
Delinquency rate (over 30 days)	0.63%	0.50%	0.13%	0.09%	1.05%
Delinquency rate (over 90 days)	0.14%	0.14%	0.03%	—%	0.51%

(1) Amounts as of and for the years ended November 30, 2011 and 2010 include securitized loans as a result of the consolidation of the securitization trusts related to a change in accounting principle on December 1, 2009. Amounts under "GAAP information" prior to December 1, 2009 do not include securitized loans.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and related notes included elsewhere in this annual report on Form 10-K. Some of the information contained in this discussion and analysis constitutes forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this annual report on Form 10-K particularly under "Risk Factors" and "Special Note Regarding Forward-Looking Statements," which immediately follows "Risk Factors." Unless otherwise specified, references to Notes to our consolidated financial statements are to the Notes to our audited consolidated financial statements as of November 30, 2011 and 2010 and for the three-year period ended November 30, 2011.

Introduction and Overview

Discover Financial Services is a direct banking and payment services company. Through our Discover Bank subsidiary, we offer our customers credit cards, student loans, personal loans and deposit products. Through our DFS Services LLC subsidiary and its subsidiaries, we operate the Discover Network, the PULSE Network ("PULSE") and Diners Club International ("Diners Club"). The Discover Network is a payment card transaction processing network for Discover card-branded and third-party issued credit, debit and prepaid cards. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE Network with access to ATMs domestically and internationally, as well as point of sale terminals at retail locations throughout the U.S. for debit card transactions. Diners Club is a global payments network of licensees, which are generally financial institutions, that issue Diners Club branded credit cards and/or provide card acceptance services. Our fiscal year ends on November 30 of each year.

Our primary revenues consist of interest income earned on loan receivables and fees earned from customers, merchants and issuers. The primary expenses required to operate our business include funding costs (interest expense), loan loss provisions, customer rewards, and expenses incurred to grow, manage and service our loan receivables and networks. Our business activities are funded primarily through consumer deposits, securitization of loan receivables and the issuance of both secured and unsecured debt.

Change in Accounting Principle Related to Off-Balance Sheet Securitizations

Beginning with the first quarter 2010, we have included the trusts used in our securitization activities in our consolidated financial results in accordance with the Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets - an amendment of FASB Statement No. 140 ("Statement No. 166") (codified under the FASB Accounting Standards Codification ("ASC") Section 860, Transfers and Servicing) and Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretations No. 46(R) ("Statement No. 167") (codified under ASC Section 810, Consolidation), which were effective for us on December 1, 2009, the beginning of our 2010 fiscal year.

Under Statement No. 166, the trusts used in our securitization transactions are no longer exempt from consolidation. Statement No. 167 prescribes an ongoing assessment of our involvement in the activities of the trusts and our rights or obligations to receive benefits or absorb losses of the trusts that could be potentially significant in order to determine whether those entities will be required to be consolidated in our financial statements. Based on our assessment, we concluded that we are the primary beneficiary of the Discover Card Master Trust I ("DCMT") and the Discover Card Execution Note Trust ("DCENT") (the "trusts") and accordingly, we began consolidating the trusts on December 1, 2009. Using the carrying amounts of the trust assets and liabilities as prescribed by Statement No. 167, we recorded a $21.1 billion increase in total assets, a $22.4 billion increase in total liabilities and a $1.3 billion decrease in stockholders' equity (comprised of a $1.4 billion decrease in retained earnings offset by an increase of $0.1 billion in accumulated other comprehensive income). The significant adjustments to our statement of financial condition upon adoption of Statements No. 166 and 167 are outlined below:

- Consolidation of $22.3 billion of securitized loan receivables and the related debt issued from the trusts to third-party investors;
- Reclassification of $4.6 billion of certificated retained interests classified as investment securities to loan receivables;
-

- Recording of a $2.1 billion allowance for loan losses, not previously required under GAAP, for the newly consolidated and reclassified credit card loan receivables;
- Derecognition of the remaining $0.1 billion value of the interest-only strip receivable, net of tax, recorded in amounts due from asset securitization and reclassification of the remaining $1.6 billion of amounts due from asset securitization to restricted cash, loan receivables and other assets; and
- Recording of net deferred tax assets of $0.8 billion, largely related to establishing an allowance for loan losses on the newly consolidated and reclassified credit card loan receivables.

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Beginning with the first quarter 2010, our results of operations no longer reflect securitization income, but instead report interest income, net charge-offs and certain other income associated with all securitized loan receivables and interest expense associated with debt issued from the trusts to third-party investors in the same line items in our results of operations as non-securitized credit card loan receivables and corporate debt. Additionally, we no longer record initial gains on new securitization activity since securitized credit card loans no longer receive sale accounting treatment. Also, there are no gains or losses on the revaluation of the interest-only strip receivable as that asset is not recognizable in a transaction accounted for as a secured borrowing. Because our securitization transactions are being accounted for under the new accounting rules as secured borrowings rather than asset sales, the cash flows from these transactions are presented as cash flows from financing activities rather than as cash flows from operating or investing activities. Notwithstanding this accounting treatment, our securitizations are structured to legally isolate the receivables from Discover Bank, and we would not expect to be able to access the assets of our securitization trusts, even in insolvency, receivership or conservatorship proceedings. We do, however, continue to have the rights associated with our retained interests in the assets of these trusts.

Reconciliations of GAAP to Non-GAAP As-Adjusted Data

To enable the reader to better understand our financial information by reflecting period-over-period data on a consistent basis, Management's Discussion and Analysis of Financial Condition and Results of Operations presents our financial information as of and for the years ended November 30, 2011 and 2010 as compared to non-GAAP as-adjusted results of operations data for the year ended November 30, 2009, and, where necessary, we have also provided certain information as of and for the year ended November 30, 2008 and 2007 on a non-GAAP as-adjusted basis. Management believes the non-GAAP as-adjusted financial information is useful to investors as it aligns with the financial information used in management's decision-making process and in evaluating the business.

The following describes the adjustments made to arrive at the non-GAAP as-adjusted financial information:

- Settlement income adjustments - The non-GAAP as-adjusted amounts remove the impact of income received in connection with the settlement of our antitrust litigation with Visa and MasterCard during the years ended November 30, 2009 and 2008, which resulted in unusually large amounts in other income and affect comparability of results between periods.
- Special dividend interest adjustments - The non-GAAP as-adjusted amounts exclude the 2009 interest charge related to our dispute with Morgan Stanley regarding the special dividend agreement, which, among other things, specified how proceeds of the antitrust litigation with Visa and MasterCard were to be shared.
- Statements No. 166 and 167 adjustments - The non-GAAP as-adjusted amounts show how our financial data would have been presented if the trusts used in our securitization activities were consolidated into our financial statements for historical periods prior to fiscal year 2010.

We did not retrospectively adopt Statements No. 166 and 167 and, therefore, the consolidated financial statements presented in this annual report as of and for the years ended November 30, 2011 and 2010 reflect the new accounting requirements, but the historical statement of income and statement of cash flows for the year ended November 30, 2009 continue to reflect the accounting applicable prior to the adoption of the new accounting requirements.

The impacts of Statements No. 166 and 167 on our earnings summary, detail of other income and Direct Banking segment information are reflected in two steps in the reconciliations of GAAP to non-GAAP as-adjusted data in the tables below. First, we made securitization adjustments to reverse the effect of loan securitization by recharacterizing securitization income to report interest income, interest expense, provision for loan losses, discount and interchange revenue and loan fee income in the same line items as non-securitized loans. These adjustments result in a "managed basis" presentation, which we have historically included in our quarterly and annual reports to reflect the way in which our senior management evaluated our business performance and allocated resources.

Then, in addition to the adjustments to remove the litigation settlement income and the interest related to the special dividend paid to Morgan Stanley, adjustments were made to reflect results as if the trusts used in our securitization activities had been fully consolidated in our historical results. These adjustments include:

- Elimination of interest income and interest expense related to certificated retained interests classified as investment securities and associated intercompany debt;
- An adjustment to the provision for loan losses for the change in securitized loan receivables;

- Elimination of the revaluation gains or losses associated with the interest-only strip receivable, which was derecognized upon adoption of Statements No. 166 and 167; and
- An adjustment to reflect the income tax effects related to these adjustments.

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The impacts of Statements No. 166 and 167 on our effective tax rate, loan receivables and average balance sheet information and certain other selected financial data are reflected in one step, rather than two, in the reconciliations of GAAP to non-GAAP as-adjusted data set forth in the tables below as there is no meaningful difference between such information on a historical managed basis as compared to on a non-GAAP as-adjusted basis.
The following tables display a reconciliation between GAAP, previously reported managed results, and non-GAAP as-adjusted amounts that reflect the exclusion of litigation settlement proceeds and interest related to the Morgan Stanley special dividend, which were unrelated to the adoption of Statements No. 166 and 167, and reflect the full impact the consolidation of our trusts would have had if we had adopted Statements No. 166 and 167 retrospectively.
Earnings Summary and Reconciliation

	For the Year Ended November 30, 2009				
	As Reported	Securitization Adjustments	Managed	Additional Adjustments	Non-GAAP As-Adjusted
	(dollars in thousands)				
Interest income	$3,145,080	$3,315,992	$6,461,072	$(25,920) (A)	$6,435,152
Interest expense	1,251,284	397,136	1,648,420	(42,921) (B)	1,605,499
Net interest income	1,893,796	2,918,856	4,812,652	17,001	4,829,653
Provision for loan losses	2,362,405	1,995,936	4,358,341	764,689 (C)	5,123,030
Net interest income after provision for loan losses	(468,609)	922,920	454,311	(747,688)	(293,377)
Antitrust litigation settlement	1,891,698	—	1,891,698	(1,891,698) (D)	—
Other income	2,948,897	(922,920)	2,025,977	160,087 (E)	2,186,064
Total other income	4,840,595	(922,920)	3,917,675	(1,731,611)	2,186,064
Total other expense	2,251,088	—	2,251,088	(28,992) (F)	2,222,096
Income (loss) before income tax expense	2,120,898	—	2,120,898	(2,450,307)	(329,409)
Income tax expense (benefit)	844,713	—	844,713	(936,838) (G)	(92,125)
Net income (loss)	$1,276,185	$—	$1,276,185	$(1,513,469)	$(237,284)

(A) Elimination of interest income on certificated retained interests previously classified as investment securities and balance transfer fee income previously included in gain/loss on interest-only strip receivable.
(B) Elimination of interest expense on certificated retained interests previously classified as investment securities and an interest expense adjustment related to the discount on securitized borrowings.
(C) Provision for loan loss on the period-to-period change in securitized loans.
(D) Exclusion of settlement proceeds related to the Visa and MasterCard antitrust litigation.
(E) Elimination of gain/loss related to revaluation of interest-only strip receivable and cash collateral accounts.
(F) Exclusion of interest charge related to our dispute with Morgan Stanley regarding the special dividend agreement.
(G) Estimated income tax benefit on the pretax loss related to Statement No. 167 adjustments and exclusion of taxes on the Visa/MasterCard antitrust litigation settlement.

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Other Income and Reconciliation

	For the Year Ended November 30, 2009						
	As Reported	Securitization Adjustments	Managed	Additional Adjustments		Non-GAAP As-Adjusted
	(dollars in thousands)					
Securitization income	$1,879,304	$(1,879,304)	$—	$—		$—
Discount and interchange revenue	222,835	761,253	984,088	—		984,088
Fee products	295,066	108,180	403,246	—		403,246
Loan fee income	247,267	247,038	494,305	—		494,305
Transaction processing revenue	125,201	—	125,201	—		125,201
Merchant fees	44,248	—	44,248	—		44,248
Loss on investment securities	(3,826)	—	(3,826)	—		(3,826)
Antitrust litigation settlement	1,891,698	—	1,891,698	(1,891,698)	(A)	—
Other income	138,802	(160,087)	(21,285)	160,087	(B)	138,802
Total other income	$4,840,595	$(922,920)	$3,917,675	$(1,731,611)		$2,186,064

(A) Exclusion of settlement proceeds related to the Visa and MasterCard antitrust litigation.
(B) Elimination of gain/loss related to revaluation of interest-only strip receivable and cash collateral accounts.

Direct Banking Segment Summary and Reconciliation

	For the Year Ended November 30, 2009					
	As Reported	Securitization Adjustments	Managed	Additional Adjustments		Non-GAAP As-Adjusted
	(dollars in thousands)					
Interest income						
Credit card	$2,835,767	$3,315,992	$6,151,759	$17,543	(A)	$6,169,302
Private student loans	25,906	—	25,906	—		25,906
PCI student loans	—	—	—	—		—
Personal loans	139,247	—	139,247	—		139,247
Other	143,062	—	143,062	(43,463)	(B)	99,599
Total interest income	3,143,982	3,315,992	6,459,974	(25,920)		6,434,054
Interest expense	1,251,062	397,136	1,648,198	(42,921)	(C)	1,605,277
Net interest income	1,892,920	2,918,856	4,811,776	17,001		4,828,777
Provision for loan losses	2,362,405	1,995,936	4,358,341	764,689	(D)	5,123,030
Other income	4,600,801	(922,920)	3,677,881	(1,731,611)	(E)	1,946,270
Other expense	2,116,962	—	2,116,962	(28,992)	(F)	2,087,970
Income (loss) before income tax expense	$2,014,354	$—	$2,014,354	$(2,450,307)	(G)	$(435,953)

(A) Elimination of interest income on certificated retained interests previously classified as investment securities.
(B) Adjustments to interest income related to balance transfer fee income previously included in gain/loss on interest-only strip receivable.
(C) Elimination of interest expense on certificated retained interests previously classified as investment securities and an interest expense adjustment related to the discount on securitized borrowings.
(D) Provision for loan loss on the period-to-period change in securitized loans.
(E) Exclusion of settlement proceeds related to Visa and MasterCard antitrust litigation and elimination of gain/loss related to revaluation of interest-only strip receivable and cash collateral accounts.
(F) Exclusion of interest charge related to our dispute with Morgan Stanley regarding the special dividend agreement.

(G) Estimated income tax on the pretax loss related to Statement No. 167 adjustments and exclusion of taxes on the Visa/MasterCard antitrust litigation settlement.

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Loan Receivables Data and Reconciliation

	As of and for the Year Ended November 30,		
	2009	2008	2007
Total Loan Receivables	(dollars in thousands)		
Loan portfolio			
GAAP	$23,625,084	$25,216,611	$20,831,117
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319
Non-GAAP As-Adjusted	$50,854,146	$51,095,278	$48,180,436
Loan receivables			
GAAP	$23,625,084	$25,216,611	$20,831,117
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319
Non-GAAP As-Adjusted	$50,854,146	$51,095,278	$48,180,436
Allowance for loan losses (beginning of period)			
GAAP	$1,374,585	$759,925	$703,917
Adjustments for Statement No. 167	1,379,772	971,730	928,374
Non-GAAP As-Adjusted	$2,754,357	$1,731,655	$1,632,291
Provision for loan losses			
GAAP	$2,362,405	$1,595,615	$733,887
Adjustments for Statement No. 167	2,760,625	1,881,029	1,162,866
Non-GAAP As-Adjusted	$5,123,030	$3,476,644	$1,896,753
Charge-offs			
GAAP	$(2,165,653)	$(1,147,241)	$(839,092)
Adjustments for Statement No. 167	(2,208,036)	(1,713,409)	(1,366,949)
Non-GAAP As-Adjusted	$(4,373,689)	$(2,860,650)	$(2,206,041)
Recoveries			
GAAP	$186,562	$166,286	$161,213
Adjustments for Statement No. 167	212,100	240,422	247,439
Non-GAAP As-Adjusted	$398,662	$406,708	$408,652
Net charge-offs			
GAAP	$(1,979,091)	$(980,955)	$(677,879)
Adjustments for Statement No. 167	(1,995,936)	(1,472,987)	(1,119,510)
Non-GAAP As-Adjusted	$(3,975,027)	$(2,453,942)	$(1,797,389)
Allowance for loan losses (end of period)			
GAAP	$1,757,899	$1,374,585	$759,925
Adjustments for Statement No. 167	2,144,461	1,379,772	971,730
Non-GAAP As-Adjusted	$3,902,360	$2,754,357	$1,731,655
Net charge-offs %			
GAAP	7.45 %	4.59 %	3.40 %
Adjustments for Statement No. 167	0.32	0.42	0.43
Non-GAAP As-Adjusted	7.77 %	5.01 %	3.83 %

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	As of and for the Year Ended November 30,		
	2009	2008	2007
Total Loan Receivables	(dollars in thousands)		
Loans not accruing interest			
GAAP	$190,086	$173,123	$102,286
Adjustments for Statement No. 167	248,192	193,385	154,408
Non-GAAP As-Adjusted	$438,278	$366,508	$256,694
Delinquency rate (Over 30 Days)			
GAAP	4.92 %	4.35 %	3.26 %
Adjustments for Statement No. 167	0.39	0.21	0.32
Non-GAAP As-Adjusted	5.31 %	4.56 %	3.58 %
Delinquency rate (Over 90 Days)			
GAAP	2.58 %	2.06 %	1.51 %
Adjustments for Statement No. 167	0.20	0.11	0.16
Non-GAAP As-Adjusted	2.78 %	2.17 %	1.67 %
Delinquency rate (Loans not accruing interest)			
GAAP	0.80 %	0.69 %	0.49 %
Adjustments for Statement No. 167	0.06	0.03	0.04
Non-GAAP As-Adjusted	0.86 %	0.72 %	0.53 %
Discover Card			
Charge-offs			
GAAP	$(2,034,458)	$(1,119,362)	$(834,792)
Adjustments for Statement No. 167	(2,208,036)	(1,713,409)	(1,366,949)
Non-GAAP As-Adjusted	$(4,242,494)	$(2,832,771)	$(2,201,741)
Recoveries			
GAAP	$184,383	$165,422	$160,167
Adjustments for Statement No. 167	212,100	240,422	247,439
Non-GAAP As-Adjusted	$396,483	$405,844	$407,606
Total Discover Card Loans			
GAAP	$19,826,153	$23,348,134	$20,345,787
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319
Non-GAAP As-Adjusted	$47,055,215	$49,226,801	$47,695,106
Allowance for loan losses (end of period)			
GAAP	$1,587,107	$1,285,215	$742,507
Adjustments for Statement No. 167	2,144,461	1,379,771	971,730
Non-GAAP As-Adjusted	$3,731,568	$2,664,986	$1,714,237
Total Credit Card Loans			
Loan receivables			
GAAP	$20,230,302	$23,814,307	$20,579,923
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319

Non-GAAP As-Adjusted	$47,459,364	$49,692,974	$47,929,242

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	As of and for the Year Ended November 30,		
	2009	2008	2007
	(dollars in thousands)		
Charge-offs			
GAAP	$(2,096,573)	$(1,139,176)	$(837,210)
Adjustments for Statement No. 167	(2,208,036)	(1,713,409)	(1,366,949)
Non-GAAP As-Adjusted	$(4,304,609)	$(2,852,585)	$(2,204,159)
Recoveries			
GAAP	$185,616	$165,694	$160,202
Adjustments for Statement No. 167	212,100	240,422	247,439
Non-GAAP As-Adjusted	$397,716	$406,116	$407,641
Net charge-offs			
GAAP	$(1,910,957)	$(973,482)	$(677,008)
Adjustments for Statement No. 167	(1,995,936)	(1,472,987)	(1,119,510)
Non-GAAP As-Adjusted	$(3,906,893)	$(2,446,469)	$(1,796,518)
Allowance for loan losses (end of period)			
GAAP	$1,647,086	$1,317,811	$750,786
Adjustments for Statement No. 167	2,144,461	1,379,772	971,730
Non-GAAP As-Adjusted	$3,791,547	$2,697,583	$1,722,516
Net charge-offs %			
GAAP	7.87%	4.73%	3.41%
Adjustments for Statement No. 167	0.13	0.34	0.43
Non-GAAP As-Adjusted	8.00%	5.07%	3.84%
Delinquencies (over 30 Days)			
GAAP	$1,117,227	$1,082,942	$675,508
Adjustments for Statement No. 167	1,539,462	1,233,581	1,044,014
Non-GAAP As-Adjusted	$2,656,689	$2,316,523	$1,719,522
Delinquencies (over 90 Days)			
GAAP	$698,610	$594,325	$380,339
Adjustments for Statement No. 167	694,864	508,241	424,075
Non-GAAP As-Adjusted	$1,393,474	$1,102,566	$804,414
Delinquency Rate (over 30 days)			
GAAP	5.52%	4.55%	3.28%
Adjustments for Statement No. 167	0.08	0.11	0.31
Non-GAAP As-Adjusted	5.60%	4.66%	3.59%
Delinquency Rate (over 90 days)			
GAAP	2.92%	2.16%	1.53%
Adjustments for Statement No. 167	0.02	0.06	0.15
Non-GAAP As-Adjusted	2.94%	2.22%	1.68%

Restructured loans [A]			
GAAP	$72,924	$—	$—
Adjustments for Statement No. 167	145,258	—	—
Non-GAAP As-Adjusted	$218,182	$—	$—
Delinquency Rate (Restructured Loans) [A]			
GAAP	0.31 %	— %	— %
Adjustments for Statement No. 167	0.15	—	—
Non-GAAP As-Adjusted	0.46 %	— %	— %

(A) Data not available for the years ended November 30, 2008 and 2007.

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Average Balance Sheet Reconciliation

	For the Year Ended November 30, 2009		
	Average Balances	Interest Income/Expense	Yield
	(dollars in thousands)		
Average restricted cash			
GAAP	$—	$ —	— %
Adjustments for Statement No. 167	2,438,438	18,195	0.75
Non-GAAP As-Adjusted	$2,438,438	$ 18,195	0.75 %
Average investment securities			
GAAP	$1,581,387	$ 68,694	4.34 %
Adjustments for Statement No. 167	(1,096,270)	(43,464)	0.86
Non-GAAP As-Adjusted	$485,117	$ 25,230	5.20 %
Average credit card loan receivables			
GAAP	$24,266,782	$ 2,835,767	11.69 %
Adjustments for Statement No. 167	24,577,543	3,333,536	0.94
Non-GAAP As-Adjusted	$48,844,325	$ 6,169,303	12.63 %
Average total loan receivables			
GAAP	$26,552,574	$ 3,004,284	11.31 %
Adjustments for Statement No. 167	24,577,543	3,333,536	1.09
Non-GAAP As-Adjusted	$51,130,117	$ 6,337,820	12.40 %
Average other interest-earning assets			
GAAP	$2,338,438	$ 18,195	0.78 %
Adjustments for Statement No. 167	(2,338,438)	(18,195)	(0.78)
Non-GAAP As-Adjusted	$—	$ —	— %
Average total interest-earning assets			
GAAP	$39,989,758	$ 3,145,080	7.86 %
Adjustments for Statement No. 167	23,581,273	3,290,072	2.26
Non-GAAP As-Adjusted	$63,571,031	$ 6,435,152	10.12 %
Average allowance for loan losses			
GAAP	$(1,808,493)		
Adjustments for Statement No. 167	(1,741,736)		
Non-GAAP As-Adjusted	$(3,550,229)		
Average other assets (non-interest bearing)			
GAAP	$4,053,270		
Adjustments for Statement No. 167	(913,561)		
Non-GAAP As-Adjusted	$3,139,709		
Average total assets			
GAAP	$42,234,535		
Adjustments for Statement No. 167	20,925,976		

Non-GAAP As-Adjusted	$63,160,511			
Average securitized borrowings				
GAAP	$—	$ —	—	%
Adjustments for Statement No. 167	22,720,700	354,215	1.56	
Non-GAAP As-Adjusted	$22,720,700	$ 354,215	1.56	%
Average total borrowings				
GAAP	$2,486,187	$ 64,200	2.58	%
Adjustments for Statement No. 167	22,720,700	354,215	(0.92	)
Non-GAAP As-Adjusted	$25,206,887	$ 418,415	1.66	%
Average total interest-bearing liabilities				
GAAP	$31,609,777	$ 1,251,284	3.96	%
Adjustments for Statement No. 167	22,720,700	354,215	(1.00	)
Non-GAAP As-Adjusted	$54,330,477	$ 1,605,499	2.96	%

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	For the Year Ended November 30, 2009 Average Balances (dollars in thousands, except where noted)
Average other liabilities and stockholders' equity (non-interest earning)	
GAAP	$10,624,758
Adjustments for Statement No. 167	(1,794,724)
Non-GAAP As-Adjusted	$8,830,034
Average total liabilities and stockholders' equity	
GAAP	$42,234,535
Adjustments for Statement No. 167	20,925,976
Non-GAAP As-Adjusted	$63,160,511

	Ratios and Other Amounts
Net interest margin	
GAAP	7.13 %
Adjustments for Statement No. 167	2.32
Non-GAAP As-Adjusted	9.45 %
Net yield on interest-earning assets	
GAAP	4.74 %
Adjustments for Statement No. 167	2.86
Non-GAAP As-Adjusted	7.60 %
Interest rate spread	
GAAP	3.90 %
Adjustments for Statement No. 167	3.26
Non-GAAP As-Adjusted	7.16 %
Amortization of balance transfer fees in interest income on credit card loans (dollars in millions)	
GAAP	$128
Adjustments for Statement No. 167	59
Non-GAAP As-Adjusted	$187

	For the Year Ended November 30,	
	2008	2007
	(dollars in thousands)	
Total average loan receivables		
GAAP	$21,348,493	$19,947,784
Adjustments for Statement No. 167	27,662,655	26,965,690
Non-GAAP As-Adjusted	$49,011,148	$46,913,474

Total loans interest yield				
GAAP	10.89	%	10.73	%
Adjustments for Statement No. 167	1.70		1.92	
Non-GAAP As-Adjusted	12.59	%	12.65	%
Total average credit card loan receivables				
GAAP	$20,566,864		$19,845,880	
Adjustments for Statement No. 167	27,662,655		26,965,690	
Non-GAAP As-Adjusted	$48,229,519		$46,811,570	
Credit card interest yield				
GAAP	10.92	%	10.75	%
Adjustments for Statement No. 167	1.71		1.91	
Non-GAAP As-Adjusted	12.63	%	12.66	%

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2011 Highlights

- Net income in 2011 was $2.2 billion as compared to net income of $765 million in 2010.
- Discover card sales volume showed strong year-over-year growth of 8% totaling $100.1 billion in 2011 as compared to $92.5 billion in 2010. This growth was driven primarily by an increase in spending by both new and existing customers partially due to increased marketing.
- The delinquency rate for our credit card loans over 30 days past due improved dramatically during 2011, reaching an all-time low at November 30, 2011 of 2.39%, which was down from the prior year rate of 4.06%. The primary reason for this decline was the improvement throughout 2011 in the underlying credit quality of our portfolio as the U.S. economy stabilized following an extended period of increasing unemployment levels.
- Our total loan portfolio increased 18% year-over-year to $56.6 billion, mainly due to the acquisition of The Student Loan Corporation ("SLC") in December 2010, which added approximately $3.1 billion of private student loans to our portfolio, and the acquisition of approximately $2.4 billion of private student loans from Citibank, N.A. ("Citi") in September 2011. In addition, $1.5 billion is attributed to an increase in credit card loans due to higher volumes and lower charge offs.
- Payment Services continued to produce strong results with pretax income of $166 million, up 18% over the prior year. Transaction volume for the segment was $177 billion, an increase of 16% as compared to the prior year.
- We repurchased 18 million shares, or approximately 3%, of our outstanding common stock for $425 million in 2011.

2010 and 2009 Highlights

- Our revenues were unfavorably impacted in 2010 by the implementation of certain provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD" Act), which included limitations on our ability to reprice accounts, the elimination of overlimit fees and a reduction in the amount of standard late fees.
- We settled our antitrust litigation with Visa and MasterCard for $2.75 billion in 2008. Through 2009, we received a total of $1.9 billion ($1.2 billion after tax) from Visa for its portion of the settlement. At the time of our spin-off, we entered into an agreement with Morgan Stanley to determine how proceeds from the litigation would be shared, among other things. In 2010, we paid Morgan Stanley a dividend of $775 million under an amendment to that agreement.

Recent Developments

- On December 9, 2011, we entered into definitive agreements to sell substantially all of our remaining $714 million of federal student loans currently classified as loans held for sale. The majority of these loans were pledged as collateral against a long-term borrowing and, as part of this transaction, these borrowings are expected to be assumed by the purchaser. These transactions, which are subject to customary closing conditions, including the receipt of governmental approvals, are expected to close in February 2012.
- Effective December 16, 2011, we terminated our $2.4 billion unsecured committed credit facility. This facility had no borrowings against it as of November 30, 2011. For more information, see "- Liquidity and Capital Resources - Liquidity Management."
- On January 19, 2012, we paid a dividend of $0.10 per share of our common stock, which was an increase from the $0.06 per share dividend that we paid in the previous quarter.

Outlook

Credit performance continued to improve through 2011 as we approached historical lows in delinquency and net charge-off rates. In 2012, we do not expect reserve releases to continue at previous levels and we anticipate that growth in our loan portfolio will lead to increases in loan loss reserves. We are focused on growing our card receivables in 2012 through new account acquisitions and wallet share gains resulting from marketing and advertising efforts as well as increased acceptance by merchants in the U.S. and major international destinations for U.S. travelers. We are also targeting solid growth and strong returns in our private student and personal loan portfolios, while continuing to pursue other opportunities to diversify our direct banking business, such as our pending acquisition of the mortgage origination business of Tree.com, Inc.

We anticipate further total yield compression in 2012 due to the continuing effects of CARD Act implementation, an increase in promotional offers and the expected growth in personal and private student loans, which tend to carry

lower interest rates than our card receivables. We expect this yield compression to be somewhat offset by continued funding cost improvements. Funding costs are expected to continue to decline over the next year as we benefit from the interest rate environment and replace higher-priced time deposits with lower cost borrowings. Net interest margin is expected to remain relatively stable through 2012. As in 2011, we intend to continue to maintain a strong capital level while targeting investments for future growth and returning capital to shareholders through dividends and our share repurchase program.

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Our payments business had strong volume growth in 2011. We continue to focus on investments to build brand awareness and acceptance globally through support of our Diners Club network and arrangements with other networks and merchant acquirers. Recently, we have been successful in developing relationships with leading merchant acquirers in key markets, including Canada, the United Kingdom and Western Europe, to further increase acceptance and volumes. PULSE, our debit card network, in preparation for the April 1, 2012 effective date of the federal regulations mandating that debit and prepaid card issuers participate in two or more unaffiliated payment networks, has increased its processing capacity for potential additional volume.

Regulatory Environment and Developments

Overview

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Reform Act”) contains a comprehensive set of provisions designed to govern the practices and oversight of financial institutions and other participants in the financial markets. The Reform Act addresses risks to the economy and the payments system, especially those posed by large systemically significant financial firms. Bank holding companies with $50 billion or more in total consolidated assets ("covered companies"), including Discover, are considered systemically significant under the Reform Act and are subject to heightened prudential standards to be established by the Federal Reserve. Certain provisions of the Reform Act that may have a significant impact on us are described in more detail below under the headings "- Consumer Financial Services," "- Payment Networks," "- Capital and Liquidity" and "- Asset-Backed Securities." The Reform Act also provides for restrictions on and additional disclosure of executive compensation, additional corporate governance requirements and far more stringent requirements with respect to affiliate transactions and mergers and acquisitions.

The effect of the Reform Act and other regulatory initiatives on our business and operations could be significant, depending upon final implementing regulations, the actions of our competitors and the behavior of consumers and other marketplace participants. The Reform Act, other legislative and regulatory changes, and enhanced scrutiny by our regulators could have a significant impact on us by, for example, requiring us to limit or change our business practices, limiting our ability to pursue business opportunities, requiring us to invest valuable management time and resources in compliance efforts, imposing additional costs on us, limiting fees we can charge for services, requiring us to meet more stringent capital, liquidity and leverage ratio requirements (including those under Basel III), increasing our cost or ability to access the securitization markets for our funding, impacting the value of our assets, or otherwise adversely affecting our businesses. For additional information regarding the impact of the Reform Act and other regulatory initiatives on us, see "Risk Factors."

Consumer Financial Services

The Reform Act established the Consumer Financial Protection Bureau (the “CFPB”), which regulates consumer financial products and services provided by certain financial services providers, including Discover. In July 2011, many consumer financial protection functions formerly assigned to the federal banking and other agencies transferred to the CFPB. The CFPB is authorized to prevent “unfair, deceptive or abusive practices” and ensure consistent enforcement of laws so that all consumers have access to markets for consumer financial products and services that are fair, transparent and competitive. The CFPB has rulemaking and interpretive authority under the Reform Act and other federal consumer financial services laws (including the CARD Act), as well as broad supervisory, examination and enforcement authority over large providers of consumer financial products and services, such as Discover. State officials are authorized to enforce consumer protection rules issued by the CFPB and other requirements of the Reform Act. The CFPB is already engaged in consumer education, supervision, examination and investigatory activities. In late 2011, it began tracking consumer complaints for credit cards and mortgages via an online process that is expected to expand to student loans in 2012.

There is significant legislative and regulatory focus on the student loan market, including by the CFPB, which has made the student loan market a priority area of focus. Under the Reform Act, the CFPB and Department of Education (“DOE”) are required to prepare a report on private education loans and private educational lenders by July 2012 that examines, among other things, the private education loan market; underwriting criteria used by lenders; loan terms, conditions and pricing; consumer protections available to borrowers; and fair lending considerations. The Reform Act

also created a "Private Education Ombudsman" within the CFPB to receive and attempt to informally resolve complaints about private student loans, and the CFPB plans to receive such complaints via its online consumer complaint system. In addition, the Obama Administration has made changes to the federal student loan program intended to make college more affordable and make it easier for students to repay their federal student loans. Congress or the Administration may take actions that impact the student loan market in the future, including as a result of the CFPB and DOE study. The possible impact of heightened scrutiny of the student loan market and its participants, including any resulting legislative and regulatory initiatives, is uncertain and may adversely impact the profitability and growth of our private student loan portfolio.

Our banking regulators have introduced and continue to introduce new regulations and supervisory guidance and practices in response to the heightened Congressional and regulatory focus on consumer financial services generally, increasing their scrutiny over us and the industry. Also, additional legislative or regulatory action that may impact our businesses may result from the multiple studies mandated under the Reform Act, such as the CFPB and DOE study of private student loans referenced above. We are unable to predict whether any additional changes to statutes or regulations affecting the consumer financial services industry, including the interpretation or implementation thereof, will occur in the future.

Payment Networks

Certain Reform Act provisions require that interchange fees paid to or charged by payment card issuers on debit card and certain prepaid transactions be “reasonable” and “proportional” to the issuer's cost in connection with such transactions, as determined by the Federal Reserve. The Reform Act also prohibits debit and prepaid card networks and issuers from requiring debit and prepaid card transactions to be processed solely on a single payment network, or two or more affiliated payment networks. In addition, provisions of the Reform Act prohibit credit/debit network rules that restrict merchants from offering discounts to customers in order to encourage them to use a particular form of payment, or from setting minimum transaction amounts of $10.00 or less for use of credit cards, as long as such merchant practices do not differentiate on the basis of the issuer or network. The Federal Reserve issued final implementing regulations with respect to the interchange fee and routing provisions in June 2011, some of which became effective in October 2011. Regulations mandating that debit and prepaid card issuers participate in two or more unaffiliated payment networks take effect April 1, 2012.

Discover Network and PULSE have modified operating rules, interchange fee schedules and existing agreements to ensure consistency with the Reform Act and Federal Reserve implementing regulations. PULSE has increased its processing capacity for potential additional volume. The ultimate impact of these laws and regulations will depend upon the actions of our competitors and the behavior of other marketplace participants. For example, the National Retail Federation, the Food Marketing Institute, the National Association of Convenience Stores and two retailers have filed a federal lawsuit challenging the Federal Reserve implementing regulations and, in particular, the interchange fee provisions, on the grounds that, among other things, the Federal Reserve did not properly apply the Reform Act. It is uncertain how PULSE's business practices, network transaction volume, revenue, and prospects for future growth, as well as the debit card market as a whole, may be impacted by the industry's competitive response to these new requirements.

Capital and Liquidity

Consistent with Reform Act requirements to impose enhanced prudential standards on covered companies, in November 2011, the Federal Reserve issued a final rule requiring covered companies to submit annual capital plans to the Federal Reserve for its review and non-objection. A capital plan must include an assessment of the expected uses and sources of capital over the planning horizon (at least nine quarters, beginning with the quarter preceding the quarter in which the covered company submits its capital plan) that reflects the company's size, complexity, risk profile, and scope of operations, assuming both expected and stressful conditions. The capital plan must include a calculation of regulatory capital ratios over the planning horizon under expected conditions and under a range of stressed scenarios and discussion of how the company will maintain capital above each minimum capital ratio, including a pro forma Tier 1 common ratio (meaning the ratio of Tier 1 common capital to total risk-weighted assets) above 5%, under these scenarios.

The instructions accompanying the Federal Reserve's final rule regarding capital plans indicate that the Federal Reserve expects covered companies to show that they can achieve “readily and without difficulty the ratios required by the Basel III framework as they would come into effect in the United States." "Basel III" refers to two consultative documents released by the Basel Committee on Banking Supervision (the "Basel Committee") in December 2009, the rules text released in December 2010 and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage and liquidity requirements. Implementation of Basel III in the U.S. will require implementing regulations and guidelines by U.S. banking regulators, which may differ in significant ways from the recommendations published by the Basel Committee. It is unclear how U.S. banking regulators will define “well-capitalized” in their implementation of Basel III. We continue to monitor the implementation of Basel III in the

U.S. Based on current industry expectations regarding the content of the regulations to be implemented and our capital profile, we currently anticipate that we will be able to meet the regulatory requirements.

Under the Federal Reserve's final capital plan rule, covered companies with capital plans viewed as unsatisfactory by the Federal Reserve will face limits on their ability to make capital distributions, including share repurchases and dividends. Further, a covered company generally will be required to obtain the prior approval of the Federal Reserve to make capital distributions in certain other cases, including if after giving effect to the distribution the covered company would not meet a minimum regulatory capital ratio, including a Tier 1 common ratio of at least 5%, the capital distribution would exceed the amount set forth in the covered company's approved capital plan or the Federal Reserve makes certain determinations. A covered company must update and re-submit its capital plan to the Federal Reserve within 30 calendar days (subject to extension) if there has been or will be a material change in the company's risk profile, financial condition, or corporate structure, and will generally not be able to make a capital distribution unless the Federal Reserve has approved such distribution.

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In addition, on December 20, 2011, the Federal Reserve issued proposed rules to implement Reform Act heightened prudential standards requirements related to risk-based capital and leverage; liquidity; single-counterparty credit limits; overall risk management and risk committees; stress tests; and a debt-to-equity limit for covered companies that the Financial Stability Oversight Council has determined pose a grave threat to financial stability. The proposal also includes rules to implement the early remediation requirements in the Reform Act related to establishing measures of financial condition and remediation requirements that increase in stringency as the financial condition of a covered company declines.

The capital, leverage and stress test proposals work in tandem with the Federal Reserve's annual capital plan requirements by establishing a framework for capital stress testing under which the Federal Reserve would, on an annual basis, conduct an analysis of a covered company's capital, taking into account all relevant exposures and activities of the covered company to evaluate the ability of the covered company to absorb losses and continue to function as a credit intermediary as a result of adverse and severely adverse economic and financial market conditions. The Federal Reserve will conduct its analysis using a minimum of three different sets of economic and financial conditions (scenarios), including baseline, adverse, and severely adverse conditions, and will make public a summary of the results, including company specific information. Further, covered companies will be required to perform one or more company-run capital stress tests each year using a baseline, adverse, and severely adverse scenario provided by the Federal Reserve as well as a baseline, adverse and severely adverse scenario developed by the covered company, and to make a summary of the results public.

In the initial phase, covered companies will be subject to the Federal Reserve's capital plan rule, described above, including the requirement to maintain a Tier 1 common ratio greater than 5%. The Federal Reserve states that, in a second phase, it intends to supplement the enhanced risk-based capital requirements contained in its capital plan rule with a subsequent proposal to implement a quantitative risk-based capital surcharge for covered companies or a subset of covered companies. The quantitative risk-based capital surcharge would be based on the Basel Committee's approach and implementation timeframe, which contemplates adopting implementing rules in 2014 and requiring global systemically important banks to meet the capital surcharges on a phased-in basis from 2016-2019. The Federal Reserve also notes that it and the other U.S. federal banking agencies are continuing to work on implementing the other Basel III capital requirements in the United States but, other than with respect to the capital surcharge, does not provide further details with respect to such implementation.

The Federal Reserve proposed rules related to liquidity would subject covered companies to a set of enhanced liquidity risk management standards, including liquidity stress testing. The proposal would require covered companies to conduct internal stress tests at least monthly to measure their liquidity needs during times of instability in the financial markets and to hold “highly liquid assets” that would be sufficient to cover 30-day stressed net cash outflows under their internal stress scenarios. Covered companies also would be required to meet specified corporate governance requirements around liquidity risk management, to project cash flow needs over various time horizons, to establish internal limits on certain liquidity metrics, and to maintain a contingency funding plan that identifies potential sources of liquidity strain and alternative sources of funding when usual sources of liquidity are unavailable. The Federal Reserve indicates that, in a second phase, it and the other U.S. federal banking agencies plan to issue one or more proposals to implement quantitative liquidity requirements based on Basel III that would be applicable to all or a subset of covered companies.

On January 17, 2012, the FDIC approved a notice of proposed rulemaking to implement the provisions of the Reform Act that require state nonmember banks with consolidated assets of more than $10 billion, such as Discover Bank, to conduct annual capital adequacy stress tests. In terms of its requirements, the notice of proposed rulemaking is substantively similar to the Federal Reserve’s December 20, 2011 proposed rules described above. Also on January 17, 2012, the FDIC approved a final rule requiring an insured depository institution with $50 billion or more in total assets, such as Discover Bank, to submit to the FDIC periodic contingency plans for resolution in the event of the institution's failure. This final rule follows an interim final rule relating to insured depository institution resolution plans and separate joint rulemaking with the Federal Reserve that the FDIC approved in September 2011 pursuant to Section 165(d) of the Reform Act requiring bank holding companies with $50 billion or more in consolidated assets (including us) and certain other financial companies to submit a resolution plan (or so-called “living will”) to the FDIC,

the Federal Reserve, and the Financial Stability Oversight Council for their rapid and orderly liquidation in the event of material financial distress or failure. The FDIC's final rule and the separate joint rulemaking rules are meant to be complementary and use the same staggered submission schedule. Under the rules, the initial resolution plans for us and Discover Bank are required to be submitted on or before December 31, 2013. Thereafter, we and Discover Bank are required to update such plans annually and, in certain circumstances, more frequently.

Asset-Backed Securities

The Reform Act also imposes a number of significant changes relating to the asset-backed securities and structured finance markets, some of which may impact our ability and/or desire to utilize those markets to meet funding and liquidity needs. For more information regarding these and other changes related to asset-backed securities that may impact us, see "Risk Factors - If we are unable to securitize our receivables, it may have a material adverse effect on our liquidity, cost of funds and overall financial condition," "- Liquidity and Capital Resources - Funding Sources - Credit Card Securitization Financing" and "- Liquidity and Capital Resources - Credit Ratings."

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Results of Operations

The discussion below provides a summary of our results of operations for the year ended November 30, 2011, compared to our results of operations for the year ended November 30, 2010, and for the year ended November 30, 2009 on a non-GAAP as-adjusted basis. The discussion also provides information about our loan receivables as of November 30, 2011, compared to November 30, 2010, and November 30, 2009 on a non-GAAP as-adjusted basis. In certain tables, quantitative information about our loan receivables as of November 30, 2008 and 2007 are also shown on a non-GAAP as-adjusted basis. For a reconciliation of GAAP to non-GAAP as-adjusted financial data, see " - Reconciliations of GAAP to Non-GAAP As-Adjusted Data." All information and comparisons are based solely on continuing operations.

Segments

We manage our business activities in two segments: Direct Banking and Payment Services. In compiling the segment results that follow, our Direct Banking segment bears all overhead costs that are not specifically associated with a particular segment and all costs associated with Discover Network marketing, servicing and infrastructure, with the exception of an allocation of direct and incremental costs driven by our Payment Services segment.

Direct Banking. Our Direct Banking segment includes Discover card-branded credit cards issued to individuals and small businesses and other consumer banking products and services, including personal loans, student loans, prepaid cards and other consumer lending and deposit products offered through our Discover Bank subsidiary. The majority of our Direct Banking revenues relate to interest income earned on each of our loan products. Additionally, our credit card products generate substantially all of our revenues related to discount and interchange, fee products and loan fee income.

Payment Services. Our Payment Services segment includes PULSE, an automated teller machine, debit and electronic funds transfer network; Diners Club, a global payments network; and our third-party issuing business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties. The majority of our Payment Services revenues relate to transaction processing revenue from PULSE and royalty and licensee revenue (included in other income) from Diners Club.

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The following table presents segment data (dollars in thousands):

	For the Year Ended November 30,		
	2011	2010	2009
Direct Banking[1]			
Interest income			
Credit card	$5,654,088	$5,836,002	$6,169,302
Private student loans	115,307	47,518	25,906
PCI student loans	225,096	—	—
Personal loans	266,081	181,652	139,247
Other	84,529	81,027	99,599
Total interest income	6,345,101	6,146,199	6,434,054
Interest expense	1,484,335	1,582,745	1,605,277
Net interest income	4,860,766	4,563,454	4,828,777
Provision for loan losses	1,013,350	3,206,705	5,123,030
Other income	1,907,322	1,827,414	1,946,270
Other expense	2,409,584	2,056,685	2,087,970
Income before income tax expense	3,345,154	1,127,478	(435,953)
Payment Services			
Interest income	38	19	1,098
Interest expense	217	243	222
Net interest expense	(179)	(224)	876
Provision for loan losses	—	—	—
Other income	297,852	267,585	239,794
Other expense	131,583	125,980	134,126
Income before income tax expense	166,090	141,381	106,544
Total income before income tax expense	$3,511,244	$1,268,859	$(329,409)

(1) The 2009 Direct Banking segment information is presented on a non-GAAP as-adjusted basis. No adjustments have been made to the Payment Services segment. See reconciliations in " —Reconciliations of GAAP to Non-GAAP As-Adjusted Data."

The following table presents information on transaction volume (in thousands):

	For the Year Ended November 30,		
	2011	2010	2009
Network Transaction Volume			
PULSE Network	$140,119,224	$118,178,821	$109,302,121
Third-Party Issuers	7,532,898	6,802,480	5,671,555
Diners Club [1]	29,274,940	27,132,901	26,172,977
Total Payment Services	176,927,062	152,114,202	141,146,653
Discover Network—Proprietary[2]	103,527,058	95,759,835	90,688,997
Total Volume	$280,454,120	$247,874,037	$231,835,650
Transactions Processed on Networks			
Discover Network	1,721,697	1,605,114	1,513,955
PULSE Network	3,823,930	3,308,543	2,878,720
Total	5,545,627	4,913,657	4,392,675
Credit Card Volume			
Discover Card Volume [3]	$108,086,521	$98,698,861	$95,592,170
Discover Card Sales Volume [4]	$100,137,826	$92,470,523	$87,460,552

(1)

Diners Club volume is derived from data provided by licensees for Diners Club branded cards issued outside North America and is subject to subsequent revision or amendment.

(2) Represents gross proprietary sales volume on the Discover Network.

(3) Represents Discover card activity related to net sales, balance transfers, cash advances and fee-based products.

(4) Represents Discover card activity related to net sales.

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Direct Banking

For the Year Ended November 30, 2011 compared to the Year Ended November 30, 2010

Our Direct Banking segment reported pretax income of $3.3 billion for the year ended November 30, 2011, as compared to pretax income of $1.1 billion for the year ended November 30, 2010.

Loan receivables totaled $57.3 billion at November 30, 2011, which was up from $48.8 billion at November 30, 2010. This was primarily driven by the increase in private student loans due to the acquisition of $3.1 billion of loans from SLC in the first quarter of 2011 (see Note 4: Business Combinations to our consolidated financial statements), and an additional $2.4 billion of student loans acquired in the fourth quarter of 2011 (see Note 6: Loan Receivables to our consolidated financial statements). Credit card loan receivables were $46.6 billion at November 30, 2011, which was up from $45.2 billion at November 30, 2010. Personal loan receivables were $2.6 billion at November 30, 2011, which was up from $1.9 billion at November 30, 2010. Discover card sales volume was $100.1 billion for the year ended November 30, 2011, an increase of 8% as compared to the same period in 2010. This growth was driven primarily by an increase in spending by both new and existing customers partially due to increased marketing.

Net interest margin rose slightly for the year ended November 30, 2011 as compared to the same period in 2010. This was driven by an increase in yield on our liquidity portfolio and a decrease in interest expense as a percentage of total loans, partially offset by a decline in yield related to loans. The increase in yield on our liquidity portfolio was driven by a shift to higher yielding investment securities. The decrease in interest expense was related to maturities of deposits bearing higher interest rates, partially offset by increased interest expense on securitized borrowings. The yield on loans declined reflecting an increase in lower yielding student loans. For a more detailed discussion on net interest income, see "-Net Interest Income."

At November 30, 2011, our delinquency rate for credit card loans over 30 days past due was 2.39% as compared to 4.06% at November 30, 2010, reflective of improvement throughout 2011 in the underlying credit quality of our portfolio. For the year ended November 30, 2011, our net charge-off rate on credit cards declined to 4.50%, as compared to 8.08% for the same period in 2010. A reduction in the loan loss reserve rate and a decline in the level of net charge-offs led to a decline in the provision for loan losses for the year ended November 30, 2011 as compared to the same period in 2010. For a more detailed discussion on provision for loan losses, see "-Loan Quality-Provision and Allowance for Loan Losses."

Total other income increased for the year ended November 30, 2011 as compared to the same period in 2010, primarily due to the inclusion of income from the transition service agreement related to the acquisition of SLC in first quarter 2011 (see Note 4: Business Combinations to our condensed consolidated financial statements). Furthermore, discount and interchange revenue and revenue from fee products increased during the year ended November 30, 2011 as compared to the same period in 2010. These increases were partially offset by a decline in loan fee income as well as a modest loss on investments. The increase in discount and interchange revenue was driven by higher sales volume, partially offset by higher Cashback Bonus rewards. Higher levels of revenue from fee products were driven by lower charge-offs relating to these products during the year ended November 30, 2011 as compared to the same period in 2010. Gain on investments declined for the year ended November 30, 2011 as compared to the same period in 2010 due to the inclusion of a gain of $19.6 million related to the liquidation of the collateral supporting the asset-backed commercial paper notes of Golden Key U.S. LLC ("Golden Key") during 2010. There was not a similar benefit recognized in 2011. Furthermore, other income in 2010 also included a $23 million charge related to the decision we made in 2010 to sell our remaining federal student loans. There was no such charge to other income during 2011.

Total other expense increased for the year ended November 30, 2011 as compared to the same period in 2010 primarily due to higher compensation expenses from increased headcount and higher bonuses. Furthermore, there were higher marketing and business development costs related to new account acquisitions. Professional fees also increased due to higher costs related to key technology initiatives, costs relating to the SLC acquisition, as well as an increase in costs related to efforts to recover charged-off accounts. Furthermore, other expense also rose due to an increase in fraud related costs, an increase in legal reserves related to pending litigation and higher investments in various growth initiatives. For the year ended November 30, 2010, other expense benefited from a $29 million expense reversal related to the payment to Morgan Stanley under an amendment to the special dividend agreement that occurred in the first quarter of 2010. There was not a similar benefit recognized in 2011.

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For the Year Ended November 30, 2010 compared to the Year Ended November 30, 2009

Our Direct Banking segment had pretax income of $1.1 billion for the year ended November 30, 2010 as compared to a reported pretax income of $2.0 billion (which included $1.9 billion in income from the settlement of our antitrust litigation) and a non-GAAP as-adjusted pretax loss of $436 million for the year ended 2009.

Discover card sales volume was up for the year ended November 30, 2010 as compared to 2009 reflecting higher average spend per customer and a continued increase in merchant acceptance. Loan receivables totaled $48.8 billion at November 30, 2010, which was down from $50.9 billion at November 30, 2009 on a non-GAAP as-adjusted basis, reflecting a decline in credit card loans and federal student loans, partially offset by an increase in personal loans and private student loans. Although sales volumes increased, credit card loans declined as a result of a reduction in promotional rate balances and an increase in the payment rate. In 2010, we sold $1.5 billion in federal student loans to the U.S. Department of Education and classified the remaining $788 million of federal student loan balances as held for sale.

Net interest income declined during 2010 as compared to 2009 on a non-GAAP as-adjusted basis, largely due to a decline in the average level of credit card loan receivables as well as a lower net interest margin. The decline in net interest margin is reflective of the impact of legislative changes on credit card yield and an increase in the average level of lower rate student loan balances, partially offset by higher interest rates earned on standard balances and fewer promotional rate balances.

At November 30, 2010, our over 30 days delinquency rate was 3.89% as compared to 5.31% at November 30, 2009 on a non-GAAP as-adjusted basis, reflective of continued improvement in credit performance. For the year ended November 30, 2010, our net charge-off rate declined to 7.57%, compared to 7.77% for the year ended November 30, 2009 on a non-GAAP as-adjusted basis. Provision for loan losses for the year ended November 30, 2010 was lower as compared to November 30, 2009 on a non-GAAP as-adjusted basis primarily due to a reduction in the loan loss reserve rate and a decline in the level of net charge-offs.

Total other income decreased in 2010 as compared to 2009 on a non-GAAP as-adjusted basis primarily due to the discontinuance of overlimit fees on consumer credit card loans beginning in February 2010 and a decline in late fees beginning in August 2010 in connection with implementing the provisions of the CARD Act. Other income in 2010 also included a $23 million charge related to the decision we made in 2010 to sell our remaining federal student loans. This decrease was partially offset by an increase in discount and interchange revenue and a $19.6 million gain related to the liquidation of collateral supporting our Golden Key investment.

Total other expense decreased during 2010 as compared to 2009 on a non-GAAP as-adjusted basis, as the impact of the cost containment initiatives begun in 2009, particularly those related to employee compensation and benefits and information processing and communications, largely offset the impact of higher marketing expenses. Additionally, the first quarter of 2010 benefited from a $29 million expense reversal related to the payment to Morgan Stanley under an amendment to the special dividend agreement, while the second quarter of 2009 included a $20 million restructuring charge related to a reduction in force.

Payment Services

For the Year Ended November 30, 2011 compared to the Year Ended November 30, 2010

Our Payment Services segment reported pretax income of $166 million for the year ended November 30, 2011, up $25 million as compared to the same period during 2010 as a result of higher volumes and margins from transactions on the PULSE network. Expenses increased due to higher employee compensation due to higher headcount and investments related to enhancing our processing capacity.

Transaction dollar volume increased $25 billion for the year ended November 30, 2011 as compared to the year ended November 30, 2010, primarily driven by increased PULSE volume. The number of transactions on the PULSE network increased by 16% for the year ended November 30, 2011, as compared to the same period in 2010.

For the Year Ended November 30, 2010 compared to the Year Ended November 30, 2009

Our Payment Services segment reported pretax income of $141 million for the year ended November 30, 2010, up $35 million as compared to the year ended November 30, 2009. Revenues were up $28 million as a result of increased volumes from new and existing clients, as well as higher margins from transactions on the PULSE network. Expenses were down $8 million primarily due to transaction processing cost reduction initiatives as well as a lower level of

international marketing investments.

Transaction dollar volume for the year ended November 30, 2010 was $152 billion, an increase of 8% compared to the year ended November 30, 2009. The increase in transaction dollar volume was driven by higher volumes from all three contributors of our payments business, particularly PULSE volume. The number of transactions on the PULSE network

increased by 15% for the year ended November 30, 2010 as compared to 2009.

Critical Accounting Estimates

In preparing our consolidated financial statements in conformity with GAAP, management must make judgments and use estimates and assumptions about the effects of matters that are uncertain. For estimates that involve a high degree of judgment and subjectivity, it is possible that different estimates could reasonably be derived for the same period. For estimates that are particularly sensitive to changes in economic or market conditions, significant changes to the estimated amount from period to period are also possible. Management believes the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts in our consolidated financial statements, the resulting changes could have a material effect on our consolidated results of operations and, in certain cases, could have a material effect on our consolidated financial condition. Management has identified the estimates related to our allowance for loan losses, the accrual of credit card customer rewards cost, the evaluation of goodwill and other nonamortizable intangible assets for potential impairment, estimates of future cash flows associated with purchased credit-impaired loans and the accrual of income taxes as critical accounting estimates.

Allowance for Loan Losses

We base our allowance for loan loss on several analyses that help us estimate incurred losses as of the balance sheet date. While our estimation process includes historical data and analysis, there is a significant amount of judgment applied in selecting inputs and analyzing the results produced to determine the allowance. We use a migration analysis to estimate the likelihood that a loan will progress through the various stages of delinquency. The migration analysis considers uncollectible principal, interest and fees reflected in the loan receivables. Management also estimates loss emergence by using other analyses to estimate losses incurred from non-delinquent accounts. The considerations in these analyses include past performance, risk management techniques applied to various accounts, historical behavior of different account vintages, current economic conditions, recent trends in delinquencies, bankruptcy filings, account collection management, policy changes, account seasoning, loan volume and amounts, payment rates, and forecasting uncertainties. Given the same information, others may reach different reasonable estimates.

If management used different assumptions in estimating incurred net loan losses, the impact to the allowance for loan losses could have a material effect on our consolidated financial condition and results of operations. For example, a 10% change in management's estimate of incurred net loan losses could have resulted in a change of approximately $221 million in the allowance for loan losses at November 30, 2011, with a corresponding change in the provision for loan losses. See “ - Loan Quality” and Note 3: Summary of Significant Accounting Policies to our consolidated financial statements for further details about our allowance for loan losses.

Customer Rewards Cost

We offer our customers various reward programs, including the Cashback Bonus reward program, pursuant to which we offer certain customers a reward equal to a percentage of their purchase amounts based on the type and volume of the customer's purchases. The liability for customer rewards is included in accrued expenses and other liabilities in our consolidated statements of financial condition. We compute our rewards liability on an individual customer basis and it is accumulated as qualified customers make progress toward earning a reward through their ongoing purchase activity. The liability is adjusted for expected forfeitures of accumulated rewards. In determining the forfeiture estimate, we consider historical rewards redemption and forfeiture behavior, the level of recent customer purchase activity and the terms of the current rewards programs. We generally recognize reward costs as a reduction of discount and interchange revenue in the consolidated statements of income.

If management used a different estimate of forfeitures, our consolidated statement of financial condition and results of operations could have differed. For example, a 100 basis point decrease in the estimated forfeiture rate as of November 30, 2011, could have resulted in an increase in accrued expenses and other liabilities of approximately $12 million. The corresponding increase in rewards cost would have been reflected as a decrease in discount and interchange revenue. See “ - Other Income” and Note 3: Summary of Significant Accounting Policies to our consolidated financial statements for further details about credit card rewards cost.

Goodwill and Other Nonamortizable Intangible Assets

We recognize goodwill when the purchase price of an acquired business exceeds the total of the fair values of the acquired net assets. In addition, we have recognized certain other nonamortizable intangible assets in our acquisition of the Diners Club business. As required by GAAP, we test goodwill and other nonamortizable intangible assets for impairment annually, or more often if indicators of impairment exist. In evaluating goodwill for impairment, management must estimate the fair value of the business unit(s) to which the goodwill relates. Because market data concerning acquisitions of comparable

businesses typically are not readily obtainable, other valuation techniques such as earnings multiples and cash flow models are used in estimating the fair values of these businesses. Similarly, in evaluating the other nonamortizable intangible assets for potential impairment, management estimates their fair values using discounted cash flow models. In applying these techniques, management considers historical results, business forecasts, market and industry conditions and other factors. We may also consult independent valuation experts where needed in applying these valuation techniques. The valuation methodologies we use involve assumptions about business performance, revenue and expense growth, discount rates and other assumptions that are judgmental in nature.

If economic conditions deteriorate or other events adversely impact the assumptions used by management in these valuations, we may be exposed to an impairment loss that, when recognized, could have a material impact on our consolidated financial condition and results of operations. At November 30, 2011, there were no reporting units or intangible assets that were at reasonable risk for failing the respective impairment evaluations.

Income Taxes

We are subject to the income tax laws of the jurisdictions where we have business operations, primarily the United States, its states and municipalities. We must make judgments and interpretations about the application of these inherently complex tax laws when determining the provision for income taxes and must also make estimates about when in the future certain items will affect taxable income in the various taxing jurisdictions. Disputes over interpretations of the tax laws may be settled with the taxing authority upon examination or audit. We regularly evaluate the likelihood of assessments in each of the taxing jurisdictions resulting from current and subsequent years' examinations, and tax reserves are established as appropriate.

Changes in the estimate of income taxes can occur due to tax rate changes, interpretations of tax laws, the status and resolution of examinations by the taxing authorities, and newly enacted laws and regulations that impact the relative merits of tax positions taken. When such changes occur, the effect on our consolidated financial condition and results of operations can be significant. See Note 17: Income Taxes to our consolidated financial statements for additional information about income taxes.

Purchased Credit-Impaired Loans

The estimate of expected future cash flows on purchased credit-impaired ("PCI") loans determines the amount of yield we can recognize in future periods and impacts whether a loan loss reserve must be established for these loans. We re-evaluate the amount and timing of expected cash flows quarterly using updated loan portfolio characteristics as well as assumptions regarding expected borrower default and prepayment behavior. Because estimates of expected future cash flows on PCI loans involve assumptions and significant judgment, it is reasonably possible that others could derive different estimates than ours for the same periods. In addition, changes in estimates from one period to the next can have a significant impact on our consolidated financial condition and results of operations. A decrease in expected cash flows involving an increase in estimated credit losses would result in an immediate charge to earnings for the recognition of a loan loss provision. Increases or decreases in expected cash flows related solely to changes in estimated prepayments or to changes in variable interest rate indices would result in prospective yield adjustments over the remaining life of the loans. An increase in expected cash flows due to a reduction in expected credit losses would result first in the reversal of any previously established loan loss reserve on PCI loans through an immediate credit to earnings and then, if needed, a prospective adjustment to yield over the remaining life of the loans.

If management used a different estimate of expected borrower defaults, our consolidated statement of financial condition and results of operations could have differed. For example, a 10% increase in the expected borrower default rate of each PCI loan pool as of November 30, 2011 could have resulted in an impairment of up to $55 million. This impairment would have been reflected as an increase in provision for loan losses and a decrease in the carrying value of the PCI loans. The accounting and estimates used in our calculations are discussed further in Note 6: Loan Receivables to our consolidated financial statements.

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Earnings Summary

The following table outlines changes in our consolidated statements of income for the periods presented (dollars in thousands):

	For the Year Ended November 30,			2011 vs. 2010 increase (decrease)		2010 vs. 2009 increase (decrease)	
	2011	2010	2009 (Non-GAAP As-Adjusted [1])	$	%	$	%
Interest income	$6,345,139	$6,146,218	$6,435,152	$198,921	3%	$(288,934)	(4)%
Interest expense	1,484,552	1,582,988	1,605,499	(98,436)	(6)%	(22,511)	(1)%
Net interest income	4,860,587	4,563,230	4,829,653	297,357	7%	(266,423)	(6)%
Provision for loan losses	1,013,350	3,206,705	5,123,030	(2,193,355)	(68)%	(1,916,325)	(37)%
Net interest income (loss) after provision for loan losses	3,847,237	1,356,525	(293,377)	2,490,712	NM	1,649,902	NM
Other income	2,205,174	2,094,999	2,186,064	110,175	5%	(91,065)	(4)%
Other expense	2,541,167	2,182,665	2,222,096	358,502	16%	(39,431)	(2)%
Income (loss) before income tax expense	3,511,244	1,268,859	(329,409)	2,242,385	NM	1,598,268	NM
Income tax expense (benefit)	1,284,536	504,071	(92,125)	780,465	NM	596,196	NM
Net income (loss)	$2,226,708	$764,788	$(237,284)	$1,461,920	NM	$1,002,072	NM

(1) See "—Reconciliations of GAAP to Non-GAAP As-Adjusted Data."

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Net Interest Income

The tables that follow this section have been provided to supplement the discussion below and provide further analysis of net interest income, net interest margin and the impact of rate and volume changes on net interest income. Net interest income represents the difference between interest income earned on our interest-earning assets and the interest expense incurred to finance those assets. We analyze net interest income in total by calculating net interest margin (interest income, net of interest expense, as a percentage of average total loan receivables) and net yield on interest-bearing assets (net interest income as a percentage of average total interest-earning assets). We also separately consider the impact of the level of loan receivables and the related interest yield and the impact of the cost of funds related to each of our funding sources, along with the income generated by our liquidity investment portfolio, on net interest income.

Our interest-earning assets consist of: (i) loan receivables, (ii) cash and cash equivalents, which includes amounts on deposit with the Federal Reserve, certain highly rated certificates of deposit, and triple-A rated government mutual funds, (iii) restricted cash, (iv) short-term investments and (v) investment securities. Our interest-bearing liabilities consist primarily of deposits, both direct-to-consumer and brokered, and long-term borrowings, including amounts owed to securitization investors. Net interest income is influenced by the following:

- The level and composition of loan receivables, including the proportion of credit card loans to other consumer loans, as well as the proportion of loan receivables bearing interest at promotional rates as compared to standard rates;
- The credit performance of our loans, particularly with regard to charge-offs of finance charges, which reduce interest income;
- The terms of long-term borrowings and certificates of deposit upon initial offering, including maturity and interest rate;
- The level and composition of other interest-bearing assets and liabilities, including our liquidity investment portfolio;
- Changes in the interest rate environment, including the levels of interest rates and the relationships among interest rate indices, such as the prime rate, the Federal Funds rate and LIBOR;
- The effectiveness of interest rate swaps in our interest rate risk management program; and
- The difference between the carrying amount and future cash flows expected to be collected on PCI loans.

For the Year Ended November 30, 2011 compared to the Year Ended November 30, 2010

Net interest margin rose slightly for the year ended November 30, 2011 as compared to the same period in 2010. This was driven by an increase in yield on our liquidity portfolio, as well as a decrease in interest expense as a percentage of total loans, partially offset by a decline in yield related to loans.

Interest income on loan receivables increased during the year ended November 30, 2011 as compared to the year ended November 30, 2010, as an increase in interest income from other consumer loans was partially offset by a decline in interest income from credit card loans. The increase in interest income from other consumer loans for the year ended November 30, 2011 as compared to the same period in 2010 is primarily attributable to the acquisition of SLC during the first quarter of 2011, as well as growth in personal loans. For the year ended November 30, 2011, the decline in interest income from credit card loans was mostly driven by a decline in yield caused by an increase in promotional rate balances and a decrease in customers who carry a balance on their cards, partially offset by lower interest charge-offs. Furthermore, the decline in yield was also impacted by the CARD Act that was implemented in 2010, which led to restrictions on imposing default interest rates on existing balances.

Interest income on other interest-earning assets, which largely relates to investment income on our liquidity investment portfolio, increased primarily due to a shift in the mix of our liquidity investment portfolio in the fourth quarter of 2010 from cash and cash equivalents to investments in securities of the U.S Treasury and U.S. government agencies, which typically have a higher yield than cash and cash equivalents.

Interest expense declined in the year ended November 30, 2011 as compared to the same period in 2010. This was primarily due to a decline in interest expense related to maturities of deposits bearing higher interest rates. This was partially offset by an increase in interest expense on securitized borrowings, primarily due to the acquisition of three

SLC securitization trusts in the first quarter of 2011 which have higher funding costs than our credit card securitizations.

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For the Year Ended November 30, 2010 compared to the Year Ended November 30, 2009

Net interest income was $4.6 billion for the year ended November 30, 2010, a decline of 6% as compared to the year ended November 30, 2009 on a non-GAAP as-adjusted basis. The decline in net interest income was primarily due to a lower average level of credit card loan receivables as well as a decline in net interest margin.

Net interest margin was 9.14% for the year ended November 30, 2010, down 31 basis points as compared to the year ended November 30, 2009 on a non-GAAP as-adjusted basis. This reflects a greater proportion of lower-rate student loans in our loan portfolio for much of the year, lower rates earned on higher balances in our liquidity investment portfolio and higher rates paid on long-term borrowings, partially offset by lower deposit funding costs and an improvement in credit card yield. Yield on credit card loan receivables improved as a result of fewer promotional rate balances and higher interest rates earned on standard balances, partially offset by the impact of legislative changes related to restrictions on increasing interest rates on existing balances beginning in February 2010. Although the yield on credit card loan receivables was higher for the full year 2010 as compared to 2009 on a non-GAAP as-adjusted basis, the credit card yield during the fourth quarter 2010 was lower than the fourth quarter 2009 on a non-GAAP as-adjusted basis.

The level of net interest income also declined during the year ended November 30, 2010, as compared to the year ended November 30, 2009 on a non-GAAP as-adjusted basis, because of a decline in the average level of credit card loan receivables, which was driven by a reduction in promotional rate balances and an increase in the payment rate. This was partially offset by an increase in the level of student loans and a higher average level of liquidity.

Interest expense declined slightly for the year ended November 30, 2010 as compared to the year ended November 30, 2009 on a non-GAAP as-adjusted basis largely as a result of lower interest expense on securitized debt and deposits offset by higher expense associated with subordinated debt issuances in late 2009 and April 2010. Interest expense on securitized debt declined because of a significant level of maturities in the first half of 2010. Interest expense on deposits declined as the decline in deposit interest rates more than offset the higher level of deposit borrowings, which replaced the maturing asset-backed securities.

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Average Balance Sheet Analysis

	2011			2010			2009 (Non-GAAP As-Adjusted [1])		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest	Average Balance	Rate	Interest
Assets									
Interest-earning assets:									
Cash and cash equivalents	$3,920,401	0.24 %	$9,569	$9,628,759	0.25 %	$24,319	$8,854,380	0.56 %	$50,024
Restricted cash	1,179,733	0.14 %	1,672	2,124,343	0.16 %	3,419	2,438,438	0.75 %	18,195
Other short-term investments	153,013	1.07 %	1,639	235,549	1.03 %	2,435	662,979	0.59 %	3,883
Investment securities	5,660,114	1.05 %	59,365	1,688,453	1.55 %	26,222	485,117	5.20 %	25,230
Loan receivables[2]:									
Credit card[3][4]	45,204,829	12.51 %	5,654,088	45,616,791	12.79 %	5,836,002	48,844,325	12.63 %	6,169,303
Personal loans	2,228,226	11.94 %	266,081	1,592,661	11.41 %	181,653	1,223,841	11.38 %	139,247
Federal student loans[5]	753,666	1.58 %	11,904	1,817,990	1.23 %	22,439	626,422	1.39 %	8,698
Private student loans	1,637,260	7.04 %	115,307	826,807	5.75 %	47,518	363,985	4.73 %	17,208
PCI student loans	3,104,504	7.25 %	225,096	—	— %	—	—	— %	—
Other	14,137	2.95 %	418	54,938	4.02 %	2,211	71,544	4.70 %	3,364
Total loan receivables	52,942,622	11.85 %	6,272,894	49,909,187	12.20 %	6,089,823	51,130,117	12.40 %	6,337,820
Total interest-earning assets	63,855,883	9.94 %	6,345,139	63,586,291	9.67 %	6,146,218	63,571,031	10.12 %	6,435,152
Allowance for loan losses	(2,710,377)			(3,870,545)			(3,550,229)		
Other assets	3,791,077			3,978,625			3,139,709		
Total assets	$64,936,583			$63,694,371			63,160,511		
Liabilities and Stockholders' Equity									
Interest-bearing liabilities:									
Interest-bearing deposits:									
Time deposits[6]	$25,477,735	3.34 %	849,743	$27,274,405	3.82 %	1,042,683	24,748,485	4.51 %	1,116,816
Money market deposits	4,656,321	1.23 %	57,314	4,303,762	1.36 %	58,745	4,091,867	1.59 %	64,902
Other interest-bearing savings deposits	5,996,123	1.33 %	79,719	2,980,286	1.65 %	49,076	283,238	1.89 %	5,366

Total interest-bearing deposits[7]	36,130,179	2.73	%	986,776	34,558,453	3.33	%	1,150,504	29,123,590	4.08	%	1,187,084
Borrowings:												
Short-term borrowings	127,840	0.10	%	133	410	0.24	%	1	837,452	0.30	%	2,538
Securitized borrowings	15,968,420	2.10	%	335,143	17,247,078	1.58	%	272,535	22,720,700	1.56	%	354,215
Other long-term borrowings[6]	2,467,806	6.58	%	162,500	2,736,017	5.85	%	159,948	1,648,735	3.74	%	61,662
Total borrowings	18,564,066	2.68	%	497,776	19,983,505	2.16	%	432,484	25,206,887	1.66	%	418,415
Total interest-bearing liabilities	54,694,245	2.71	%	1,484,552	54,541,958	2.90	%	1,582,988	54,330,477	2.96	%	1,605,499
Other liabilities and stockholders' equity	10,242,338				9,152,413				8,830,034			
Total liabilities and stockholders' equity	$64,936,583				$63,694,371				63,160,511			
Net interest income				$4,860,587				$4,563,230				$4,829,653
Net interest margin[8]		9.18	%			9.14	%			9.45	%	
Net yield on interest-bearing assets[9]		7.61	%			7.18	%			7.60	%	
Interest rate spread[10]		7.23	%			6.77	%			7.16	%	

(1) Information related to restricted cash, investment securities, credit card loan receivables, allowance for loan losses, other assets, securitized borrowings, other long-term borrowings and other liabilities and stockholders' equity are presented on a non-GAAP as-adjusted basis. No adjustments have been made for cash and cash equivalents, other short-term investments, other loan receivables, interest-bearing deposits, short-term borrowings and other long-term borrowings. See " - Reconciliations of GAAP to Non-GAAP As Adjusted Data."

(2) Average balances of loan receivables include non-accruing loans, which are included in the yield calculations. If the non-accruing loan balances were excluded, there would not be a material impact on the amounts reported above.

(3) Interest income on credit card loans includes $225 million, $173 million and $187 million on a non-GAAP as-adjusted basis of amortization of balance transfer fees for the years ended November 30, 2011, 2010 and 2009 respectively.

(4) Includes the impact of interest rate swap agreements used to change a portion of certain floating-rate credit card loan receivables to fixed-rates.

(5) Includes federal student loans held for sale.

(6) Includes the impact of interest rate swap agreements used to change a portion of fixed-rate funding to floating-rate funding.

(7) Includes the impact of FDIC insurance premiums and special assessments, and all periods reflect management's product allocation methodology as of fourth quarter 2011.

(8) Net interest margin represents net interest income as a percentage of average total loan receivables.

(9) Net yield on interest-bearing assets represents net interest income as a percentage of average total interest-earning assets.

(10) Interest rate spread represents the difference between the rate on total interest-earning assets and the rate on total interest-bearing liabilities.

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Rate/Volume Variance Analysis[1]

	2011 vs. 2010			2010 vs. 2009		
	Volume	Rate	Total	Volume	Rate	Total
Increase/(decrease) in net interest income due to changes in:						
Interest-earning assets:						
Cash and cash equivalents	$(13,959)	$(791)	$(14,750)	$4,045	$(29,750)	$(25,705)
Restricted cash	(1,377)	(370)	(1,747)	(2,085)	(12,691)	(14,776)
Other short-term investments	(881)	85	(796)	(3,379)	1,931	(1,448)
Investment securities	44,085	(10,942)	33,143	28,364	(27,372)	992
Loan receivables:						
Credit card	(52,366)	(129,548)	(181,914)	(412,055)	78,754	(333,301)
Personal loans	75,537	8,891	84,428	42,066	340	42,406
Federal student loans	(15,623)	5,088	(10,535)	15,024	(1,283)	13,741
Private student loans	55,115	12,674	67,789	25,915	4,395	30,310
PCI student loans	225,096	—	225,096	—	—	—
Other	(1,319)	(474)	(1,793)	(711)	(442)	(1,153)
Total loan receivables	286,440	(103,369)	183,071	(329,761)	81,764	(247,997)
Total interest income	314,308	(115,387)	198,921	(302,816)	13,882	(288,934)
Interest-bearing liabilities:						
Interest-bearing deposits:						
Time deposits	(65,703)	(127,237)	(192,940)	107,010	(181,143)	(74,133)
Money market deposits	4,597	(6,028)	(1,431)	3,234	(9,391)	(6,157)
Other interest-bearing savings deposits	41,626	(10,983)	30,643	44,503	(793)	43,710
Total interest-bearing deposits	(19,480)	(144,248)	(163,728)	154,747	(191,327)	(36,580)
Borrowings:						
Short-term borrowings	134	(2)	132	(2,123)	(414)	(2,537)
Securitized borrowings	(21,427)	84,035	62,608	(86,431)	4,751	(81,680)
Other long-term borrowings	(16,545)	19,097	2,552	53,016	45,270	98,286
Total borrowings	(37,838)	103,130	65,292	(35,538)	49,607	14,069
Total interest expense	(57,318)	(41,118)	(98,436)	119,209	(141,720)	(22,511)
Net interest income	$371,626	$(74,269)	$297,357	$(422,025)	$155,602	$(266,423)

(1) The rate/volume variance for each category has been allocated on a consistent basis between rate and volume variances between November 30, 2011, November 30, 2010 and November 30, 2009 on a non-GAAP as-adjusted basis, based on the percentage of the rate or volume variance to the sum of the two absolute variances.

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Loan Quality

Loan receivables consist of the following (dollars in thousands):

	For the Years Ended November 30,				
	2011	2010	2009 (Non-GAAP As-Adjusted[1])	2008 (Non-GAAP As-Adjusted[1])	2007 (Non-GAAP As-Adjusted[1])
Loans held for sale	$714,180	$788,101	$—	$—	$—
Loan portfolio:					
Credit card loans:					
Discover card	46,419,544	44,904,267	47,055,215	49,226,801	47,695,106
Discover business card	219,081	252,727	404,149	466,173	234,136
Total credit card loans	46,638,625	45,156,994	47,459,364	49,692,974	47,929,242
Other consumer loans:					
Personal loans	2,648,051	1,877,633	1,394,379	1,028,093	165,529
Federal student loans	—	—	1,352,587	167,749	4,380
Private student loans	2,069,001	999,322	579,679	132,180	8,440
Other	16,690	14,363	68,137	74,282	72,845
Total other consumer loans	4,733,742	2,891,318	3,394,782	1,402,304	251,194
PCI student loans[(2)]	5,250,388	—	—	—	—
Total loan portfolio	56,622,755	48,048,312	50,854,146	51,095,278	48,180,436
Total loan receivables	57,336,935	48,836,413	50,854,146	51,095,278	48,180,436
Allowance for loan losses	(2,205,196)	(3,304,118)	(3,902,360)	(2,754,357)	(1,731,655)
Net loan receivables	$55,131,739	$45,532,295	$46,951,786	$48,340,921	$46,448,781

(1) Discover card loan balances and the allowance for loan losses are presented on a non-GAAP as-adjusted basis. No adjustments have been made to loans held for sale, Discover business card, personal loans, federal or private student loans or other loans. See reconciliation in " - Reconciliations of GAAP to Non-GAAP As-Adjusted Data."

(2) Represents purchased credit-impaired private student loans which do not have a related allowance for loan losses or charge-offs (see Note 6: Loan Receivables to our consolidated financial statements).

Provision and Allowance for Loan Losses

Provision for loan losses is the expense related to maintaining the allowance for loan losses at an appropriate level to absorb the estimated probable losses in the loan portfolio at each period end date. Factors that influence the provision for loan losses include:

- The impact of general economic conditions on the consumer, including unemployment levels, bankruptcy trends and interest rate movements;
- Changes in consumer spending and payment behaviors;
- Changes in our loan portfolio, including the overall mix of accounts, products and loan balances within the portfolio;
- The level and direction of historical and anticipated loan delinquencies and charge-offs;
- The credit quality of the loan portfolio, which reflects, among other factors, our credit granting practices and effectiveness of collection efforts; and
- Regulatory changes or new regulatory guidance.

In calculating the allowance for loan losses, we estimate probable losses separately for segments of the loan portfolio that have similar risk characteristics, such as credit card and other consumer loans. For consumer loans, we use a migration analysis to estimate the likelihood that a loan will progress through the various stages of delinquency. We use other analyses to estimate losses incurred from non-delinquent accounts which adds an additional element to the identification of loss emergence. We use these analyses together to determine our allowance for loan losses.

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For the year ended November 30, 2011, the provision for loan losses decreased $2.2 billion as compared to the year ended November 30, 2010. This decrease was primarily due to improved credit performance, which resulted in a decline in the level of net charge-offs, discussed in " - Net Charge-offs" below. Improvements in credit performance were also evidenced by a decline in the delinquency rate for the year, which was the primary driver of the reduction in the allowance for loan losses. At November 30, 2011, the allowance for loan losses was $2.2 billion, a decrease of $1.1 billion from November 30, 2010.

For the year ended November 30, 2010, the provision for loan losses decreased $1.9 billion as compared to the year ended November 30, 2009 on a non-GAAP as-adjusted basis. This decrease was attributable to lower net charge-offs and a reduction in the allowance for loan losses. The reduction in the allowance for loan losses was due to improved delinquency statistics, which resulted in lower loan loss reserve rates, as well as a $2.3 billion decline in the level of credit card loans. More specifically, our allowance at November 30, 2010 was $3.3 billion, a decline of $598 million as compared to November 30, 2009 on a non-GAAP as-adjusted basis. This full-year net reduction in the allowance includes a $305 million increase to the allowance in the first quarter 2010 upon management's consideration of refined analytics that expanded its ability to identify loss emergence.

At November 30, 2011, the level of the allowance related to other consumer loans increased by $40 million as compared to November 30, 2010 mainly due to the increase in private student loan receivables as well as the seasoning of the loan portfolio. At November 30, 2010, the level of the allowance related to other consumer loans decreased by $16 million as compared to November 30, 2009. This was largely attributable to a decline in our personal loan reserve rate due to credit improvement in that portfolio. This was partially offset by a reserve increase related to a higher level of private student loans.

The following table provides changes in our allowance for loan losses for the periods presented (dollars in thousands):

	For the Year Ended November 30,				
	2011	2010	2009 (Non-GAAP As-Adjusted[1])	2008 (Non-GAAP As-Adjusted[1])	2007 (Non-GAAP As-Adjusted[1])
Balance at beginning of period	$3,304,118	$1,757,899	$ 2,754,357	$ 1,731,655	$ 1,632,291
Additions:					