CAPITAL ONE FINANCIAL CORP
Form 10-Q
August 05, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2011

OR

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

For the transition period from to

Commission File No. 1-13300

CAPITAL ONE FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware **(State or Other Jurisdiction of** **Incorporation or Organization)**	**54-1719854** **(I.R.S. Employer** **Identification No.)**
1680 Capital One Drive, **McLean, Virginia** **(Address of Principal Executive Offices)**	**22102** **(Zip Code)**

Registrant s telephone number, including area code:

(703) 720-1000

(Former name, former address and former fiscal year, if changed since last report)

(Not applicable)

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 x 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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	¨
Non-accelerated filer	¨	Smaller reporting company	¨

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

As of July 31, 2011, there were 459,374,369 shares of the registrant s Common Stock, par value $.01 per share, outstanding.

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PART I FINANCIAL INFORMATION

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read in conjunction with our unaudited condensed consolidated financial statements and related notes in this Report and the more detailed information contained in our 2010 Annual Report on Form 10-K (2010 Form 10-K). This discussion contains forward-looking statements that are based upon management s current expectations and are subject to significant uncertainties and changes in circumstances. Please review Forward-Looking Statements for more information on the forward-looking statements in this Report. Our actual results may differ materially from those included in these forward-looking statements due to a variety of factors including, but not limited to, those described in this Report in Part II Item 1A. Risk Factors, in our 2010 Form 10-K in Part I Item 1A. Risk Factors and in Exhibit 99.5 to our Current Report on Form 8-K filed on July 13, 2011.

SUMMARY OF SELECTED FINANCIAL DATA

Below we provide selected consolidated financial data from our results of operations for the three and six months ended June 30, 2011 and 2010, and selected comparative consolidated balance sheet data as of June 30, 2011, and December 31, 2010. We also provide selected key metrics we use in evaluating our performance.

Table 1: Consolidated Financial Highlights (Unaudited)

	Three Months Ended June 30,			Six Months Ended June 30,		
(Dollars in millions)	2011	2010	Change	2011	2010	Change
Income statement						
Net interest income[17]	**$ 3,136**	$ 3,097	**1%**	**$ 6,276**	$ 6,325	**(1)%**
Non-interest income	**857**	807	**6**	**1,799**	1,868	**(4)**
Total revenue	**3,993**	3,904	**2**	**8,075**	8,193	**(1)**
Provision for loan and lease losses[17]	**343**	723	**(53)**	**877**	2,201	**(60)**
Non-interest expense	**2,255**	2,000	**13**	**4,417**	3,847	**15**
Income from continuing operations before income taxes	**1,395**	1,181	**18**	**2,781**	2,145	**30**
Income tax provision	**450**	369	**22**	**804**	613	**31**
Income from continuing operations, net of taxes	**945**	812	**16**	**1,977**	1,532	**29**
Loss from discontinued operations, net of taxes[1]	**(34)**	(204)	**83**	**(50)**	(288)	**83**
Net income	**$ 911**	$ 608	**50**	**$ 1,927**	$ 1,244	**55**
Common share statistics						
Earnings per common share:						
Basic earnings per common share	**$ 2.00**	$ 1.34	**49%**	**$ 4.24**	$ 2.75	**54%**
Diluted earnings per common share	**1.97**	1.33	**48**	**4.18**	2.73	**53**
Weighted average common shares outstanding:						
Basic earnings per common share	**455.6**	452.1	**1**	**454.9**	451.6	**1**
Diluted earnings per common share	**462.2**	456.4	**1**	**461.3**	455.9	**1**

Dividends per common share	**0.05**	0.05		**0.10**	0.10	
Stock price per common share at period end	**51.67**	40.30	**28**	**51.67**	40.30	**28**
Total market capitalization at period end	**23,551**	18,228	**29**	**23,551**	18,228	**29**

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(Dollars in millions)	Three Months Ended June 30, 2011	2010	Change	Six Months Ended June 30, 2011	2010	Change
Average balances						
Loans held for investment	**$ 127,916**	$ 128,203	****%**	**$ 126,504**	$ 131,222	**(4)%**
Interest-earning assets	**174,143**	174,672	******	**173,844**	178,296	**(2)**
Total assets	**199,229**	199,357	******	**198,612**	203,159	**(2)**
Interest-bearing deposits	**109,251**	104,163	**5**	**108,944**	104,083	**5**
Total deposits	**125,834**	118,484	**6**	**125,001**	118,011	**6**
Borrowings	**39,451**	50,404	**(22)**	**39,991**	55,162	**(28)**
Stockholders equity	**28,255**	24,526	**15**	**27,636**	24,091	**15**
Performance metrics						
Purchase volume[2]	**$ 34,226**	$ 26,570	**29%**	**$ 62,023**	$ 50,494	**23%**
Revenue margin[3][17]	**9.17%**	8.94%	**23bps**	**9.29%**	9.19%	**10bps**
Net interest margin[4][17]	**7.20**	7.09	**11**	**7.22**	7.09	**13**
Net charge-off rate[5][17]	**2.91**	5.36	**(245)**	**3.28**	5.69	**(241)**
Risk-adjusted margin[6]	**7.03**	5.01	**202**	**6.90**	5.00	**190**
Return on average assets[7]	**1.90**	1.63	**27**	**1.99**	1.51	**48**
Return on average equity[8]	**13.38**	13.24	**14**	**14.31**	12.71	**160**
Non-interest expense as a % of average loans held for investment[9]	**7.05**	6.24	**81**	**6.98**	5.86	**112**
Efficiency ratio[10]	**56.47**	51.23	**524**	**54.70**	46.95	**775**
Effective income tax rate	**32.26**	31.24	**102**	**28.91**	28.58	**33**

(Dollars in millions)	June 30, 2011	December 31, 2010	Change
Balance sheet (period end)			
Loans held for investment	**$ 128,965**	$ 125,947	**2%**
Interest-earning assets	**174,302**	172,024	**1**
Total assets	**199,753**	197,503	**1**
Interest-bearing deposits	**109,278**	107,162	**2**
Total deposits	**126,117**	122,210	**3**
Borrowings	**37,735**	41,796	**(10)**
Total liabilities	**171,072**	170,962	******
Stockholders equity	**28,681**	26,541	**8**
Tangible common equity (TCE)[11]	**14,675**	12,558	**17**
Credit quality metrics (period end)			
Allowance for loan and lease losses[17]	**$ 4,488**	$ 5,628	**(20)%**
Allowance as a % of loans held of investment	**3.48%**	4.47%	**(99)bps**
30+ day performing delinquency rate[12]	**2.90**	3.52	**(62)**
30+ day delinquency rate	**3.57**	4.23	**(66)**
Capital ratios			
Tier 1 common equity ratio[13]	**9.4%**	8.8%	**40bps**
Tier 1 risk-based capital ratio[14]	**11.8**	11.6	
Total risk-based capital ratio[15]	**15.0**	16.8	**(200)**
Tangible common equity ratio (TCE ratio)[16]	**7.9**	6.9	**100**

** Change is less than one percent.

(1) Discontinued operations reflect ongoing costs related to the mortgage origination operations of GreenPoint s wholesale mortgage banking unit, GreenPoint Mortgage Funding, Inc. (GreenPoint), which we closed in 2007.

(2) Consists of credit card purchase transactions for the period, net of returns. Excludes cash advance transactions.
(3) Calculated based on annualized total revenue for the period divided by average interest-earning assets for the period.
(4) Calculated based on annualized net interest income for the period divided by average interest-earning assets for the period.
(5) Calculated based on annualized net charge-offs for the period divided by average loans held for investment for the period. Average loans held for investment include purchased credit-impaired loans acquired as part of the Chevy Chase Bank acquisition.
(6) Calculated based on annualized total revenue less net charge-offs for the period divided by average interest-earning assets for the period.
(7) Calculated based on annualized income from continuing operations, net of tax, for the period divided by average total assets for the period.
(8) Calculated based on annualized income from continuing operations, net of tax, for the period divided by average stockholders equity for the period.
(9) Calculated based on annualized non-interest expense, excluding restructuring and goodwill impairment charges, for the period divided by average loans held for investment for the period.
(10) Calculated based on non-interest expense, excluding restructuring and goodwill impairment charges, for the period divided by total revenue for the period.
(11) Tangible common equity is a non-GAAP measure consisting of total assets less assets from discontinued operations and intangible assets. See Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for the calculation of this measure and reconciliation to the comparative GAAP measure.
(12) See Consolidated Balance Sheet Analysis and Credit Performance Credit Performance Nonperforming Assets for our policies for classifying loans as nonperforming by loan category.
(13) Tier 1 common equity ratio is a non-GAAP measure calculated based on Tier 1 common equity divided by risk-weighted assets. See Liquidity and Capital Management Capital Management and Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for additional information, including the calculation of this ratio and non-GAAP reconciliation.
(14) Tier 1 risk-based capital ratio is a regulatory measure calculated based on Tier 1 capital divided by risk-weighted assets. See Liquidity and Capital Management Capital Management and Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for additional information, including the calculation of this ratio.
(15) Total risk-based capital ratio is a regulatory measure calculated based on total risk-based capital divided by risk-weighted assets. See Liquidity and Capital Management Capital Management and Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for additional information, including the calculation of this ratio.
(16) Tangible common equity ratio (TCE ratio) is a non-GAAP measure calculated based on tangible common equity divided by tangible assets. See Supplemental Tables Table A: Reconciliation of Non-GAAP Measures and Calculation of Regulatory Capital Measures for the calculation of this measure and reconciliation to the comparative GAAP measure.
(17) Interest income was reduced by $215 million in the second quarter and first six months of 2011 for amounts earned by Kohl s. The reduction in the provision for loan and lease losses attributable to Kohl s was $212 million for the second quarter and first six months of 2011. Loss sharing amounts attributable to Kohl s reduced charge-offs by $42 million in the second quarter and first six months of 2011. The expected reimbursement from Kohl s netted in our allowance for loan and lease losses was approximately $170 million as of June 30, 2011.

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INTRODUCTION

Capital One Financial Corporation (the Company) is a diversified financial services holding company with banking and non-banking subsidiaries that offer a broad array of financial products and services to consumers, small businesses and commercial clients through branches, the internet and other distribution channels. Our principal subsidiaries include:

- Capital One Bank (USA), National Association (COBNA), which currently offers credit and debit card products, other lending products and deposit products; and

- Capital One, National Association (CONA), which offers a broad spectrum of banking products and financial services to consumers, small businesses and commercial clients.

The Company and its subsidiaries are collectively referred to as we, us or our in this Report. CONA and COBNA are collectively referred to as the Banks in this Report.

Our revenues are primarily driven by lending to consumers and commercial customers and by deposit-taking activities, which generate net interest income, and by activities that generate non-interest income, including the sale and servicing of loans and providing fee-based services to customers. Customer usage and payment patterns, credit quality, levels of marketing expense and operating efficiency all affect our profitability. Our expenses primarily consist of the cost of funding our assets, our provision for loan and lease losses, operating expenses (including associate salaries and benefits, infrastructure maintenance and enhancements and branch operations and expansion costs), marketing expenses and income taxes. We had $129.0 billion in total loans outstanding and $126.1 billion in deposits as of June 30, 2011, compared with $125.9 billion in total loans outstanding and $122.2 billion in deposits as of December 31, 2010.

Our principal operations are currently organized, for management reporting purposes, into three major business segments, which are defined based on the products and services provided or the type of customer served: Credit Card, Consumer Banking and Commercial Banking. The operations of acquired businesses have been integrated into our existing business segments.

- *Credit Card:* Consists of our domestic consumer and small business card lending, national small business lending, national closed end installment lending and the international card lending businesses in Canada and the United Kingdom.

- *Consumer Banking:* Consists of our branch-based lending and deposit gathering activities for consumers and small businesses, national deposit gathering, national automobile lending and consumer home loan lending and servicing activities.

- *Commercial Banking:* Consists of our lending, deposit gathering and treasury management services to commercial real estate and middle market customers. Our middle market customers typically include commercial and industrial companies with annual revenues between $10 million to $1.0 billion.

Certain activities that are not part of a segment are included in our Other category.

Table 2 summarizes our business segment results, which we report based on income from continuing operations, net of tax, for the three and six months ended June 30, 2011 and 2010. We provide a reconciliation of our total business segment results to our consolidated U.S. GAAP results in Note 14 Business Segments of this Report.

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Table 2: Business Segment Results

	Three Months Ended June 30,							
	2011				2010			
	Total Revenue(1)		Net Income (Loss)(2)		Total Revenue(1)		Net Income (Loss)(2)	
(Dollars in millions)	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Credit Card	**$ 2,509**	**63%**	**$ 618**	**66%**	$ 2,636	67%	$ 568	70%
Consumer Banking	**1,245**	**31**	**287**	**30**	1,097	28	305	38
Commercial Banking	**395**	**10**	**142**	**15**	379	10	77	9
Other(3)	**(156)**	**(4)**	**(102)**	**(11)**	(206)	(5)	(138)	(17)
Total from continuing operations	**$ 3,993**	**100%**	**$ 945**	**100%**	$ 3,906	100%	$ 812	100%

	Six Months Ended June 30,							
	2011				2010			
	Total Revenue(1)		Net Income (Loss)(2)		Total Revenue(1)		Net Income (Loss)(2)	
(Dollars in millions)	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Credit Card	**$ 5,124**	**63%**	**$ 1,261**	**64%**	$ 5,467	67%	$ 1,057	69%
Consumer Banking	**2,414**	**30**	**502**	**25**	2,309	28	610	40
Commercial Banking	**787**	**10**	**290**	**15**	733	9	28	2
Other(3)	**(250)**	**(3)**	**(76)**	**(4)**	(311)	(4)	(163)	(11)
Total from continuing operations	**$ 8,075**	**100%**	**$ 1,977**	**100%**	$ 8,198	100%	$ 1,532	100%

(1) Total revenue consists of net interest income and non-interest income.

(2) Net income (loss) for our business segments reflects income from continuing operations, net of tax.

(3) Includes the residual impact of the allocation of our centralized Corporate Treasury group activities, such as management of our corporate investment portfolio and asset/liability management, to our business segments as well as other items as described in Note 14 Business Segments.

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EXECUTIVE SUMMARY AND BUSINESS OUTLOOK

Financial Highlights

We reported net income of $911 million ($1.97 per diluted share) in the second quarter of 2011. In comparison, we reported net income of $1.0 billion ($2.21 per diluted share) in the first quarter of 2011 and net income of $608 million ($1.33 per diluted share) in the second quarter of 2010. Net income totaled $1.9 billion ($4.18 per diluted share) for the first six months of 2011, compared with net income of $1.2 billion ($2.73 per diluted share) for the first six months of 2010.

Our earnings in the second quarter of 2011 further bolstered our Tier 1 risk-based capital ratio under Basel I to 11.8% as of June 30, 2011, up 90 basis points from 10.9% as of March 31, 2011, and comfortably above the current minimum regulatory requirement of 4.0%. Our Tier 1 common equity ratio, a non-GAAP measure, rose to 9.4% as of June 30, 2011, up 100 basis points from 8.4% as of March 31, 2011. See Supplemental Tables below for a calculation of our regulatory capital ratios and a reconciliation of our supplemental non-GAAP capital measures.

We grew loans and deposits in the second quarter of 2011. Our strategies and actions are designed to deliver profitable long-term growth through the acquisition and retention of franchise-enhancing customer relationships across our businesses. We believe that franchise-enhancing customer relationships produce strong long-term economics through low credit costs, low customer attrition and a gradual build in loan balances and revenues over time. Examples of franchise-enhancing customer relationships include transactor customers and new partnerships in our Credit Card business, long-term retail deposit customers in our Consumer Banking business and primary banking relationships with commercial customers in our Commercial Banking business. We intend to grow these customer relationships by continuing to invest in our bank infrastructure to allow us to provide more convenient and flexible customer banking options, including a broader range of fee-based and credit products and services, by leveraging our direct bank customer franchise with national reach and by continued marketing investments to further strengthen our brand. We believe our actions have created a well-positioned balance sheet and strong capital and liquidity levels which have provided us with investment flexibility to take advantage of attractive opportunities and adjust, where we believe appropriate, to changing market conditions.

Our recent investments and partnership alliances include our September 2010 acquisition of the $807 million Sony Card legacy portfolio associated with our partnership alliance with Sony Corporation of America (Sony) and our January 2011 acquisition of the existing $1.4 billion credit card loan portfolio of Hudson s Bay Company (HBC), one of the largest retailers in Canada. In April 2011, we acquired the existing $3.7 billion private-label credit card loan portfolio of Kohl s Department Stores (Kohl s) from JPMorgan Chase & Co, which consists of more than 20 million Kohl s customer accounts. In June 2011, we entered into a definitive agreement with ING Groep N.V., ING Bank N.V., ING Direct N.V., ING Direct Bancorp, collectively, the Sellers, under which we will acquire substantially all of the Sellers ING Direct business in the United States, for an estimated price of $9.0 billion at announcement. We expect the ING Direct transaction to close in late 2011 or early 2012, subject to customary closing conditions, including certain governmental clearances and approvals.

In conjunction with the announcement of the ING Direct acquisition, we announced that we expected to finance a portion of the cash consideration through a public equity raise prior to the close of the transaction. On July 19, 2011, we closed a public underwritten offering of 40 million shares of our common stock, subject to forward sale agreements. We also closed a public offering of our senior notes for total proceeds of approximately $3.0 billion. Each of these offerings is described in more detail below under Recent Acquisitions and Related Developments Equity and Debt Offerings. In addition to these public offerings, we may seek to rebalance our investment portfolio prior to the close of the ING Direct acquisition.

Our financial strength and flexibility and our experience in the credit card and direct banking businesses are key factors that we believe have enabled us to take advantage of our recent investment opportunities. We believe these factors will help us deliver attractive financial results as well as compelling value creation over time.

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Below are additional highlights of our performance for the second quarter and first six months of 2011. These highlights generally are based on a comparison to the same prior year periods. The changes in our financial condition and credit performance are generally based on our financial condition and credit performance as of June 30, 2011, compared with our financial condition and credit performance as of December 31, 2010. We provide a more detailed discussion of our financial performance in the sections following this Executive Summary and Business Outlook.

Total Company

Earnings: We reported earnings of $911 million in the second quarter of 2011 and $1.9 billion in the first six months of 2011. Our earnings increased by $303 million, or 50%, in the second quarter of 2011, and by $683 million, or 55%, in the first six months of 2011, compared with the same prior year periods. The increase in net income was attributable to lower credit costs and strong underlying credit improvement trends, including lower provision for loan and lease losses compared to the prior year periods, as well as a substantial reduction in the provision for mortgage repurchase losses for legacy mortgage related representation and warranty claims in the second quarter and first six months of 2011 as compared to the prior year periods. The impact of these factors was partially offset by higher operating expenses related to our recent acquisitions and increased marketing expenditures.

Total Loans: Period-end loans held for investment increased by $3.0 billion, or 2%, during the first six months of 2011, to $129.0 billion as of June 30, 2011, from $125.9 billion as of December 31, 2010. The increase was primarily attributable to the additions of the Kohl s portfolio of $3.7 billion and the HBC portfolio of $1.4 billion. Excluding the impact of the addition of the Kohl s and HBC portfolios, total loans decreased by $2.1 billion, or 2%, in the first six months of 2011, due to the continued expected run-off of installment loans in our Credit Card business and home loans in our Consumer Banking business, other loan paydowns and charge-offs. The impact from these factors more than offset the strong growth in purchase volume across the Domestic Card business.

Charge-off and Delinquency Statistics: Net charge-off and delinquency rates continued to improve during the second quarter of 2011. The net charge-off rate decreased to 2.91% from 3.66% in the first quarter of 2011 and 5.36% in the second quarter of 2010. The 30+ day delinquency rate decreased to 3.57% as of June 30, 2011, from 3.79% as of March 31, 2011, and 4.23% as of December 31, 2010.

Allowance for Loan and Lease Losses: As a result of the continued improvement in credit performance, we reduced our allowance by $579 million in the second quarter of 2011 and by $1.1 billion in the first six months of 2011 to $4.5 billion as of June 30, 2011. In comparison, we reduced our allowance by $1.0 billion in the second quarter of 2010 and by $1.6 billion in the first six months of 2010. The allowance as a percentage of our total loans held for investment decreased to 3.48% as of June 30, 2011, from 4.47% as of December 31, 2010.

Representation and Warranty Reserve: Our representation and warranty reserve totaled $869 million as of June 30, 2011, compared with $816 million as of December 31, 2010. This reserve relates to our mortgage loan repurchase exposure for legacy mortgage loans sold by our subsidiaries to various parties under contractual provisions that include various representations and warranties. The reserve reflects losses as of each balance sheet date that we consider to be both probable and reasonably estimable. We recorded a provision for this exposure of $37 million and $81 million in the second quarter and first six months of 2011, respectively, compared with a provision of $404 million and $628 million in the second quarter and first six months of 2010, respectively.

Business Segments

Credit Card Business: Our Credit Card business generated net income from continuing operations of $618 million and $1.3 billion in the second quarter and first six months of 2011, respectively, compared with net income from continuing operations of $568 million and $1.1 billion in the second quarter and first six months of 2010, respectively. Continued favorable credit performance was the primary driver of the improvement in our Credit Card business, resulting in a significant decrease in the provision for loan and lease losses. The provision decrease was partially offset by an increase in non-interest expense attributable to increased operating and legal costs related to the acquisitions of the private-label credit card loan portfolios of Sony, HBC and Kohl s and increased marketing expenditures.

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Consumer Banking Business: Our Consumer Banking business generated net income from continuing operations of $287 million and $502 million in the second quarter and first six months of 2011, respectively, compared with net income from continuing operations of $305 million and $610 million in the second quarter and first six months of 2010, respectively. The decrease in net income reflected the impact of a one-time pre-tax gain of $128 million recorded in the first quarter of 2010 from the deconsolidation of certain option-adjustable rate mortgage trusts and an increase in the provision for loan and lease losses due to growth in auto loans. These factors were partially offset by an increase in total revenue due to higher pricing for new auto loan originations and deposit growth resulting from our continued strategy to leverage our bank outlets to attract lower cost funding sources.

Commercial Banking: Our Commercial Banking business generated net income from continuing operations of $142 million and $290 million in the second quarter and first six months of 2011, respectively, compared with net income from continuing operations of $77 million and $28 million in the second quarter and first six months of 2010, respectively. The improvement in results for our Commercial Banking business reflected an increase in revenues, a decrease in non-interest expense and a decrease in the provision for loan and lease losses due to the continued improvement in our Commercial Banking credit performance metrics. As a result of this improvement, we reduced our allowance for loan and lease losses and recorded a negative provision for loan and lease losses of $18 million and $33 million in the second quarter and first six months of 2011, respectively. In comparison, we recorded a provision for loan and lease losses of $62 million and $300 million in the second quarter and first six months of 2010, respectively, related to our Commercial Banking business.

Business Environment and Recent Developments

Recent Business and Regulatory Developments

During the second quarter, the operating environment continued to be challenging and uncertain given global macroeconomic concerns and fragile U.S. economic conditions. The banking industry continues to face a difficult and increasingly complex environment in which economic uncertainty, regulation and changes in customer and competitor behavior impact how we allocate resources and manage operations, as well as how we position ourselves for future earnings growth. Despite these challenges, our recent partnerships and acquisitions have contributed to new account originations and an increase in purchase volumes.

We are continuing to assess the potential impact of proposed rules promulgated by the agencies charged with implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), including rules relating to resolution plans and credit exposure reports, the FDIC s orderly liquidation authority, derivatives, risk retention and other securitization matters. These rules may result in modifications to our business models and organizational structure and may subject us to escalating costs associated with any such changes.

Recent Acquisitions and Related Developments

During the past several years, we have explored opportunities to acquire financial services companies and financial assets and enter into strategic partnerships as part of our growth strategy. In the first six months of 2011, we acquired the existing credit card loan portfolios of HBC and Kohl s and announced our planned acquisition of ING Direct. We continue to evaluate and anticipate engaging in additional strategic partnerships and selected acquisitions of financial institutions and other financial assets, including credit card and other loan portfolios. We may issue common stock or debt in connection with future acquisitions, including in public offerings, to fund such acquisitions.

Hudson s Bay Company

On January 7, 2011, we acquired the existing $1.4 billion credit card loan portfolio of HBC, one of the largest retailers in Canada, from GE Capital Retail Finance. The acquisition and partnership with HBC significantly expand our credit card customer base in Canada, tripling the number of customer accounts, and provide an additional distribution channel. The acquisition included a transfer of approximately 400 employees directly involved in managing HBC s loan portfolio.

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Kohl s

On April 1, 2011, we acquired Kohl s existing $3.7 billion private-label credit card loan portfolio from JPMorgan Chase & Co., which consists of more than 20 million Kohl s customer accounts. Under the related partnership agreement with Kohl s, we share a fixed percentage of revenues, consisting of finance charges and late fees, with Kohl s, and Kohl s is responsible for reimbursing us for a fixed percentage of credit losses incurred. The revenue-sharing arrangement with Kohl s has the effect of reducing our overall revenue margins for our Domestic Card business, while the loss-sharing arrangement has the effect of reducing the net charge-off rate. However, because we replaced lower yielding cash and other investments with the Kohl s receivables, we do not expect that the addition of the Kohl s portfolio will have a material impact on our total company revenue margin or net interest margin.

Interest income was reduced by $215 million in the second quarter and first six months of 2011 for amounts earned by Kohl s. Loss sharing amounts attributable to Kohl s reduced charge-offs by $42 million in the second quarter and first six months of 2011. In addition, the expected reimbursement from Kohl s netted in our allowance for loan and lease losses was approximately $170 million as of June 30, 2011. The reduction in the provision for loan and lease losses attributable to Kohl s for the second quarter and first six months of 2011 was $212 million.

ING Direct

On June 16, 2011, we entered into a purchase and sale agreement with ING Groep N.V., ING Bank N.V., ING Direct N.V., ING Direct Bancorp, collectively, the Sellers, under which we will acquire substantially all of the Sellers ING Direct business in the United States in exchange for $6.2 billion in cash and approximately 55.9 million shares of our common stock, subject to certain adjustments described in the purchase and sale agreement. We will effect the transaction through (i) the acquisition of the equity interests of ING Bank, fsb, (ii) the acquisition of the equity interests of each of WS Realty, LLC and ING Direct Community Development LLC and (iii) the acquisition of certain assets and the assumption of certain liabilities of ING Direct Bancorp. We expect the ING Direct transaction to close in late 2011 or early 2012, subject to customary closing conditions, including certain governmental clearances and approvals.

Equity and Debt Offerings

On July 19, 2011, we closed a public offering of shares of our common stock, subject to forward sale agreements that we entered into with certain counterparties acting as forward purchasers. The forward purchasers agreed to borrow and sell to the public, through the underwriters, 40 million shares of our common stock at a price per share of $50.00. After underwriter s discounts and commissions, the net proceeds to the company will be at an initial forward sale price per share of $48.50. We did not receive any proceeds from this public offering of our shares of common stock. Under the terms of the forward sale agreements, we must settle the forward sale agreements on or before February 15, 2012. We expect to settle the forward sale agreements entirely by physical delivery of shares of common stock in exchange for cash proceeds from the forward purchasers of $1.9 billion based on the initial forward price. The forward sale price is subject to adjustment under the forward sale agreements. However, we may, subject to certain conditions, elect cash or net share settlement of all or a portion of our obligation to deliver shares of common stock. In addition, we granted the underwriters a 30-day option to purchase an additional 6 million shares of our common stock to cover any over-allotments, which shares are not subject to the forward sale agreements.

We also closed a public offering of four different series of our senior notes on July 19, 2011, for total proceeds of approximately $3.0 billion. The offering of senior notes included $250 million aggregate principal amount of our Floating Rate Senior Notes due 2014, $750 million aggregate principal amount of our 2.125% Senior Notes due 2014, $750 million aggregate principal amount of our 3.150% Senior Notes due 2016 and $1.25 billion aggregate principal amount of our 4.750% Senior Notes due 2021.

We expect to use the net proceeds of these offerings, along with cash sourced from current liquidity, to fund the $6.2 billion in cash consideration payable in connection with the ING Direct acquisition.

Business Outlook

We discuss below our current expectations regarding our total company performance and the performance of each of our business segments over the near-term based on market conditions, the regulatory environment and our business strategies as of the time we filed this Report. The statements contained in this section are based on our current expectations regarding our outlook for our financial results and business strategies. Our expectations take into account, and should be read in conjunction with, our expectations regarding economic trends and analysis of our business as discussed in Part I Item 1. Business and Part I Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations in our 2010 Form 10-K. Certain statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those in our forward-looking statements. Forward-looking statements do not reflect (i) any change in current dividend or repurchase strategies, (ii) the effect of any acquisitions, divestitures or similar transactions or (iii) any changes in laws, regulations or regulatory interpretations, in each case after the date as of which such statements are made. See Forward-Looking Statements in this Report Item 1A. Risk Factors in our 2010 Form 10-K and Exhibit 99.5 to our Current Report on Form 8-K filed on July 13, 2011, for factors that could materially influence our results.

Total Company Expectations

We continue to gain traction across all of our businesses as a result of our focus on franchise-enhancing customer relationships. We believe the recently announced ING Direct acquisition will deliver strong financial results in the near-term as well as compelling long-term value creation. As a result, we believe we are in a strong position to deliver attractive and sustainable results over the long-term, including moderate growth and attractive risk-adjusted returns on assets in our Credit Card and Auto Finance businesses, moderate growth in low-risk loans in our Commercial Banking business and strong growth in low-cost deposits and high-quality commercial and retail customer relationships. Based on recent trends and our targeted initiatives to attract new business and develop customer relationships, we expect modest year-over-year growth in ending loan balances in 2011. Although we expect growth in our period-end loan balances in 2011, we expect that our average loan balances for 2011 will be comparable to our average loan balances for 2010 given the lower starting point for our loan balances in 2011.

Business Segments Expectations

Credit Card Business

Based on the traction we are gaining in our Domestic Card business, we believe that our Domestic Card loan balances reached a low point in the first quarter of 2011. We expect modest loan growth in the second half of 2011, as the headwinds of elevated charge-offs and the run-off of the installment loan portfolio continue to diminish. We believe we are well positioned to gain market share in the new level playing field resulting from the CARD Act. We believe the credit performance improvement in our Credit Card business will continue despite elevated unemployment.

Consumer Banking Business

In our Consumer Banking business, we expect that auto originations and returns will remain strong and drive growth in auto loans in 2011. We expect that the continuing run-off of the mortgage portfolio will largely offset the growth in auto loans. While we expect that our Auto Finance business will continue to deliver strong credit performance and economic results, we believe that we have likely experienced the low point for the Auto Finance charge-off rate. We expect the Auto Finance charge-off rate will increase in the second half of 2011, driven by seasonal patterns, competitive factors and expected changes in auction prices for used vehicles. We

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believe loan pricing in some loan portfolio categories is approaching historic highs and is likely to moderate or decline over time.

Commercial Banking Business

In our Commercial Banking business, we believe that the worst of the commercial credit downturn is behind us and there is positive trajectory. However, we continue to expect some quarterly uncertainty and volatility in commercial charge-offs and nonperforming loans. We have been growing commercial loans with lower credit risk and expect further modest growth to continue in 2011. Growth in treasury management and capital market services is driving higher fee revenues and deepening relationships with our commercial customers.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with U.S. GAAP requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expenses in the consolidated financial statements. Understanding our accounting policies and the extent to which we use management judgment and estimates in applying these policies is integral to understanding our financial statements. We provide a summary of our significant accounting policies in Note 1 Summary of Significant Accounting Policies of our 2010 Form 10-K.

We have identified the following accounting policies as critical because they require significant judgments and assumptions about highly complex and inherently uncertain matters and the use of reasonably different estimates and assumptions could have a material impact on our reported results of operations or financial condition. These critical accounting policies govern:

- Fair value
- Allowance for loan and lease losses
- Asset impairment
- Representation and warranty reserve
- Revenue recognition
- Derivative and hedge accounting
- Income taxes

We evaluate our critical accounting estimates and judgments on an ongoing basis and update them as necessary based on changing conditions. The use of fair value to measure our financial instruments is fundamental to the preparation of our consolidated financial statements because we account for and record a significant portion of our assets and liabilities at fair value. Accordingly, we provide information below on financial instruments recorded at fair value in our consolidated balance sheets. Management has discussed our critical accounting policies and estimates with the Audit and Risk Committee of the Board of Directors.

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Fair Value

Fair value is defined as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date (also referred to as an exit price). The fair value accounting guidance provides a three-level fair value hierarchy for classifying financial instruments. This hierarchy is based on whether the inputs to the valuation techniques used to measure fair value are observable or unobservable. Fair value measurement of a financial asset or liability is assigned to a level based on the lowest level of any input that is significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are described below:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs, other than quoted prices in active markets for identical assets or liabilities.

Level 3: Unobservable inputs.

The degree of management judgment involved in determining the fair value of a financial instrument is dependent upon the availability of quoted prices in active markets or observable market parameters. When quoted prices and observable data in active markets are not fully available, management judgment is necessary to estimate fair value. Changes in market conditions, such as reduced liquidity in the capital markets or changes in secondary market activities, may reduce the availability and reliability of quoted prices or observable data used to determine fair value.

We have developed policies and procedures to determine when markets for our financial assets and liabilities are inactive if the level and volume of activity has declined significantly relative to normal conditions. If markets are determined to be inactive, it may be appropriate to adjust price quotes received. When significant adjustments are required to price quotes or inputs, it may be appropriate to utilize an estimate based primarily on unobservable inputs.

Significant judgment may be required to determine whether certain financial instruments measured at fair value are included in Level 2 or Level 3. In making this determination, we consider all available information that market participants use to measure the fair value of the financial instrument, including observable market data, indications of market liquidity and orderliness, and our understanding of the valuation techniques and significant inputs used. Based upon the specific facts and circumstances of each instrument or instrument category, judgments are made regarding the significance of the Level 3 inputs to the instruments fair value measurement in its entirety. If Level 3 inputs are considered significant, the instrument is classified as Level 3. The process for determining fair value using unobservable inputs is generally more subjective and involves a high degree of management judgment and assumptions.

Our financial instruments recorded at fair value on a recurring basis represented approximately 21% of our total assets of $199.8 billion as of June 30, 2011, compared with 22% of our total assets of $197.5 billion as of December 31, 2010. Financial assets for which the fair value was determined using significant Level 3 inputs represented approximately 2% of these financial instruments (less than 1% of total assets) as of June 30, 2011, and approximately 2% of these financial instruments (1% of total assets) as of December 31, 2010.

We discuss changes in the valuation inputs and assumptions used in determining the fair value of our financial instruments, including the extent to which we have relied on significant unobservable inputs to estimate fair value and our process for corroborating these inputs, in Note 13 Fair Value of Financial Instruments.

Key Controls Over Fair Value Measurement

We have a governance framework and a number of key controls that are intended to ensure that our fair value measurements are appropriate and reliable. Our governance framework provides for independent oversight and segregation of duties. Our control processes include review and approval of new transaction types, price verification and review of valuation judgments, methods, models, process controls and results. Groups independent from our trading and investing function, including our Valuations Group and Valuations Advisory Committee, participate in the review and validation process. The Valuation Advisory Committee includes senior representation from business areas, our Enterprise Risk Oversight division and our Finance division.

Our Valuations Group performs monthly independent verification of fair value measurements by comparing the methodology driven price to other market source data (to the extent available), and uses independent analytics to determine if assigned fair values are reasonable. The Valuations Advisory Committee regularly reviews and approves our valuation methodologies to ensure that our methodologies and practices are consistent with industry standards and adhere to regulatory and accounting guidance.

For additional information on our critical accounting policies and estimates, see Part II Item 7. MD&A Critical Accounting Policies and Estimates of our 2010 Form 10-K.

CONSOLIDATED RESULTS OF OPERATIONS

The section below provides a comparative discussion of our consolidated financial performance for the three and six months ended June 30, 2011 and 2010. Following this section, we provide a discussion of our business segment results. You should read this section together with our Executive Summary and Business Outlook where we discuss trends and other factors that we expect will affect our future results of operations.

Net Interest Income

Net interest income represents the difference between the interest income and applicable fees earned on our interest-earning assets, which include loans held for investment and investment securities, and the interest expense on our interest-bearing liabilities, which include interest-bearing deposits, senior and subordinated notes, securitized debt and other borrowings. We include in interest income any past due fees on loans that we deem are collectible. Our net interest margin represents the difference between the yield on our interest-earning assets and the cost of our interest-bearing liabilities, including the impact of non-interest bearing funding. We expect net interest income and our net interest margin to fluctuate based on changes in interest rates and changes in the amount and composition of our interest-earning assets and interest-bearing liabilities.

Table 3 below presents, for each major category of our interest-earning assets and interest-bearing liabilities, the average outstanding balances, interest income earned or interest expense incurred, and the average yield or cost for the three and six months ended June 30, 2011 and 2010.

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Table 3: Average Balances, Net Interest Income and Net Interest Yield

	Three Months Ended June 30,					
	2011			2010		
(Dollars in millions)	Average Balance	Interest Income/ Expense(1)	Yield/ Rate	Average Balance	Interest Income/ Expense(1)	Yield/ Rate
Assets:						
Interest-earning assets:						
Consumer loans:(2)						
Domestic(3)	**$ 88,777**	**$ 2,658**	**11.98%**	$ 91,243	$ 2,815	12.34%
International	**8,823**	**349**	**15.82**	7,427	296	15.94
Total consumer loans(3)	**97,600**	**3,007**	**12.32**	98,670	3,111	12.61
Commercial loans(3)	**30,316**	**360**	**4.75**	29,533	365	4.94
Total loans held for investment	**127,916**	**3,367**	**10.53**	128,203	3,476	10.85
Investment securities	**40,381**	**313**	**3.10**	39,022	342	3.51
Other interest-earning assets:						
Domestic	**5,148**	**16**	**1.24**	6,933	17	0.98
International	**698**	**3**	**1.72**	514		0.00
Total other interest-earning assets	**5,846**	**19**	**1.30**	7,447	17	0.91
Total interest-earning assets	**$ 174,143**	**$ 3,699**	**8.50%**	$ 174,672	$ 3,835	8.78%
Cash and due from banks	**1,870**			2,413		
Allowance for loan and lease losses	**(5,069)**			(7,735)		
Premises and equipment, net	**2,715**			2,723		
Other assets	**25,570**			27,284		
Total assets	**$ 199,229**			$ 199,357		
Liabilities and equity:						
Interest-bearing liabilities:						
Deposits	**$ 109,251**	**$ 307**	**1.12%**	$ 104,163	$ 368	1.41%
Securitized debt obligations:						
Domestic	**18,384**	**91**	**1.98**	30,333	182	2.40
International	**3,807**	**22**	**2.31**	4,915	30	2.44
Total securitized debt obligations	**22,191**	**113**	**2.04**	35,248	212	2.41
Senior and subordinated notes	**8,093**	**63**	**3.11**	8,760	72	3.29
Other borrowings	**9,167**	**80**	**3.49**	6,396	86	5.38
Total interest-bearing liabilities	**$ 148,702**	**$ 563**	**1.51%**	$ 154,567	$ 738	1.91%
Non-interest bearing deposits	**16,583**			14,321		
Other liabilities	**5,689**			5,943		
Total liabilities	**170,974**			174,831		
Stockholders equity	**28,255**			24,526		

Total liabilities and stockholders equity	**$ 199,229**			$ 199,357		
Net interest income/spread		**$ 3,136**	**6.99%**		$ 3,097	6.87%
Interest income to average interest-earning assets			**8.50%**			8.78%
Interest expense to average interest-earning assets			**1.30**			1.69
Net interest margin			**7.20%**			7.09%

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	Six Months Ended June 30,					
	2011			2010		
(Dollars in millions)	Average Balance	Interest Income/ Expense(1)	Yield/ Rate	Average Balance	Interest Income/ Expense(1)	Yield/ Rate
Assets:						
Interest-earning assets:						
Consumer loans:(2)						
Domestic(3)	**$ 87,687**	**$ 5,364**	**12.23%**	$ 93,975	$ 5,795	12.33%
International	**8,761**	**703**	**16.05**	7,619	601	15.78
Total consumer loans(3)	**96,448**	**6,067**	**12.58**	101,594	6,396	12.59
Commercial loans(3)	**30,056**	**717**	**4.77**	29,627	738	4.98
Total loans held for investment	**126,504**	**6,784**	**10.73**	131,221	7,134	10.87
Investment securities	**40,953**	**629**	**3.07**	38,525	691	3.59
Other interest-earning assets:						
Domestic	**5,698**	**32**	**1.12**	7,942	39	0.98
International	**689**	**6**	**1.74**	608	1	0.33
Total other interest-earning assets	**6,387**	**38**	**1.19**	8,550	40	0.94
Total interest-earning assets	**$ 173,844**	**$ 7,451**	**8.57%**	$ 178,296	$ 7,865	8.82%
Cash and due from banks	**1,912**			2,338		
Allowance for loan and lease losses	**(5,348)**			(8,040)		
Premises and equipment, net	**2,717**			2,724		
Other assets	**25,487**			27,841		
Total assets	**$ 198,612**			$ 203,159		
Liabilities and equity:						
Interest-bearing liabilities:						
Deposits	**$ 108,944**	**$ 629**	**1.15%**	$ 104,083	$ 767	1.47%
Securitized debt obligations:						
Domestic	**19,983**	**208**	**2.08**	34,253	390	2.28
International	**3,869**	**45**	**2.33**	5,230	64	2.45
Total securitized debt obligations	**23,852**	**253**	**2.12**	39,483	454	2.30
Senior and subordinated notes	**8,091**	**127**	**3.14**	8,758	140	3.20
Other borrowings	**8,048**	**166**	**4.13**	6,921	179	5.17
Total interest-bearing liabilities	**$ 148,935**	**$ 1,175**	**1.58%**	$ 159,245	$ 1,540	1.93%
Non-interest bearing deposits	**16,057**			13,928		
Other liabilities	**5,984**			5,895		
Total liabilities	**170,976**			179,068		
Stockholders equity	**27,636**			24,091		
Total liabilities and stockholders equity	**$ 198,612**			$ 203,159		
Net interest income/spread		**$ 6,276**	**6.99%**		$ 6,325	6.89%

Interest income to average interest-earning assets	**8.57%**	8.82%
Interest expense to average interest-earning assets	**1.35**	1.73
Net interest margin	**7.22%**	7.09%

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(1) Past due fees included in interest income totaled approximately $245 million and $312 million for the three months ended June 30, 2011 and 2010, respectively, and approximately $490 million and $644 million for the six months ended June 30, 2011 and 2010, respectively.
(2) Interest income on credit card, auto, home and retail banking loans is reflected in consumer loans. Interest income generated from small business credit cards also is included in consumer loans.
(3) In the first quarter of 2011, we revised our previously reported interest income on interest-earning assets and average yield on loans held for investment for 2010 to conform to the internal management accounting methodology used in our segment reporting. The interest income and average loan yields presented reflect this revision. The previously reported interest income and average yields for the second quarter of 2010 were as follows: domestic consumer loans ($2,882 million and 12.63%); total consumer loans ($3,178 million and 12.88%); and commercial loans ($298 million and 4.04%). The previously reported interest income and average yields for the first six months were as follows: domestic consumer loans ($5,844 million and 12.44%); total consumer loans ($6,445 million and 12.69%); and commercial loans ($689 million and 4.65%).

Table 4 presents the variance between our net interest income for the three months ended June 30, 2011 and 2010, and for the six months ended June 30, 2011 and 2010, and the extent to which the variance was attributable to: (i) changes in the volume of our interest-earning assets and interest-bearing liabilities or (ii) changes in the interest rates of these assets and liabilities.

Table 4: Rate/Volume Analysis of Net Interest Income[1]

	Three Months Ended June 30, 2011 vs. 2010			Six Months Ended June 30, 2011 vs. 2010		
	Total	Variance Due to		Total	Variance Due to	
(Dollars in millions)	**Variance**	**Volume**	**Rate**	**Variance**	**Volume**	**Rate**
Interest income:						
Loans held for investment:						
Consumer loans	**$ (104)**	**$ (34)**	**$ (70)**	**$ (329)**	**$ (325)**	**$ (4)**
Commercial loans	**(5)**	**10**	**(15)**	**(21)**	**11**	**(32)**
Total loans held for investment, including past-due fees	**(109)**	**(24)**	**(85)**	**(350)**	**(314)**	**(36)**
Investment securities	**(29)**	**12**	**(41)**	**(62)**	**42**	**(104)**
Other	**2**	**(4)**	**6**	**(2)**	**(11)**	**9**
Total interest income	**(136)**	**(16)**	**(120)**	**(414)**	**(283)**	**(131)**
Interest expense:						
Deposits	**(61)**	**17**	**(78)**	**(138)**	**34**	**(172)**
Securitized debt obligations	**(99)**	**(70)**	**(29)**	**(201)**	**(168)**	**(33)**
Senior and subordinated notes	**(9)**	**(5)**	**(4)**	**(13)**	**(11)**	**(2)**
Other borrowings	**(6)**	**30**	**(36)**	**(13)**	**27**	**(40)**
Total interest expense	**(175)**	**(28)**	**(147)**	**(365)**	**(118)**	**(247)**
Net interest income	**$ 39**	**$ 12**	**$ 27**	**$ (49)**	**$ (165)**	**$ 116**

(1) We calculate the change in interest income and interest expense separately for each item. The change in net interest income attributable to both volume and rates is allocated based on the relative dollar amount of each item.

Our net interest income of $3.1 billion for the second quarter of 2011 increased slightly from the second quarter of 2010, driven by an 11 basis points expansion of our net interest margin to 7.20%, which was partially offset by a modest decline in average interest-earning assets.

Our net interest income of $6.3 billion for the first six months of 2011 decreased slightly from the first six months of 2010, driven by a 2% decrease in average interest-earning assets, which was offset by a 13 basis points expansion of our net interest margin to 7.22%.

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The decrease in average interest-earning assets in the second quarter and first six months of 2011 reflected the continued run-off of businesses that we exited or repositioned, including our installment, home loan and small-ticket commercial real estate loan portfolios, which more than offset the impact of modest revolving credit card loan growth and the addition of the existing HBC credit card loan portfolio of $1.4 billion in the first quarter of 2011 and the addition of the existing Kohl s private-label credit card loan portfolio of $3.7 billion in the second quarter of 2011.

The increase in our net interest margin in the second quarter of 2011 and first six months of 2011 was primarily attributable to an improvement in our cost of funds, which was partially offset by a decline in the yield on our interest-earning assets. Our cost of funds continued to benefit from the shift in the mix of our funding to lower cost consumer and commercial banking deposits from higher cost wholesale sources. In addition, the overall interest rate environment, combined with our disciplined pricing, contributed to the decrease in our average deposit interest rates.

The decrease in yield on interest-earning assets was attributable to a reduction in late payment fees resulting from the Federal Reserve guidelines regarding reasonable fees that went info effect in the third quarter of 2010 and the addition of the Kohl s portfolio. Under our partnership agreement with Kohl s, we share a fixed percentage of revenues, consisting of finance charges and late fees. We report revenues related to Kohl s credit card loans on a net basis in our consolidated financial statements, which has the effect of reducing the yield on our average interest-earning assets. The impact of these factors was partially offset by the run-off of lower margin installment loans, a reduced level of new accounts with low introductory promotional rates and an increase in the recognition of billed finance charges and fees due to the improvement in credit performance.

Non-Interest Income

Non-interest income consists of servicing and securitizations income, service charges and other customer-related fees, interchange income and other non-interest income. We also record the provision for mortgage repurchase losses related to continuing operations in non-interest income. The servicing fees, finance charges, other fees, net of charge-offs and interest paid to third party investors related to our consolidated securitization trusts are reported as a component of net interest income.

Table 5 displays the components of non-interest income for the three and six months ended June 30, 2011 and 2010.

Table 5: Non-Interest Income

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in millions)	**2011**	**2010**	**2011**	**2010**
Servicing and securitizations	**$ 12**	$ 21	**$ 23**	$ (15)
Service charges and other customer-related fees	**460**	496	**985**	1,081
Interchange	**331**	333	**651**	644
Net other-than-temporary impairment	**(6)**	(26)	**(9)**	(57)
Provision for mortgage repurchase losses[1]	**(4)**	(95)	**(9)**	(195)
Other	**64**	78	**158**	410
Total non-interest income	**$ 857**	$ 807	**$ 1,799**	$ 1,868

(1) We recorded a total provision for mortgage repurchase losses of $37 million and $404 million in the second quarter of 2011 and 2010, respectively. The remaining portion of the provision for repurchase losses is included in discontinued operations.

Non-interest income of $857 million for the second quarter of 2011 increased by $50 million, or 6%, from non-interest income of $807 million for the second quarter of 2010. This increase was primarily due to a reduction in the provision for mortgage repurchase losses and a decline in other-than-temporary impairment, which was partially offset by a decrease in service charges and other customer-related fees due to the reduction in penalty fees as a result of the CARD Act. In the second quarter of 2010, we significantly increased our reserve for mortgage representation and warranty claims for legacy mortgage loans sold by our subsidiaries to various parties. The increase was primarily attributable to a refinement we made in estimating our reserve for representation and warranty claims to extend the timeframe, in most instances, over which we estimated our repurchase liability to the full life of the mortgage loans sold by our subsidiaries. We provide additional information on our reserve for representation and warranty claims in Consolidated Balance Sheet Analysis and Credit Performance Potential Mortgage Representation and Warranty Liabilities. The other-than-temporary losses recorded in the second quarter of 2010 were attributable to certain non-agency mortgage-backed securities that had deteriorated in credit quality due to the continued weakness in the housing market and elevated unemployment.

Non-interest income of $1.8 billion for the first six months of 2011 decreased by $69 million, or 4%, from non-interest income of $1.9 billion from the first six months of 2010. This decrease reflected the impact of a one-time pre-tax gain of $128 million recorded in the first quarter of 2010 as result of the deconsolidation of certain option-adjustable rate mortgage trusts and the reduction in penalty fees as a result of the CARD Act. The impact of these factors was partially offset by the decreases in the provision for mortgage repurchase losses and other-than-temporary impairment losses.

Provision for Loan and Lease Losses

We build our allowance for loan and lease losses through the provision for loan and lease losses. Our provision for loan and lease losses in each period is driven by charge-offs and the level of allowance for loan and lease losses that we determine is necessary to provide for probable credit losses inherent in our loan portfolio as of each balance sheet date.

Our provision for loan and lease losses fell by $380 million to $343 million in the second quarter of 2011 and by $1.3 billion in the first six months of 2011 to $877 million, compared with the same prior year periods. The decrease in the provision was largely driven by a substantial decline in net charge-offs across all of our business segments, as underlying credit trends and credit performance continued to improve. The net charge-off rate was 2.91% and 3.28% for the second quarter and first six months of 2011, respectively, compared with 5.36% and 5.69% for the second quarter and first six months of 2010, respectively. As charge-offs declined, we recorded an allowance release of $579 million and $1.1 billion in the second quarter and first six months of 2011, respectively.

See Consolidated Balance Sheet Analysis and Credit Performance Allowance for Loan and Lease Losses for a discussion of changes in our allowance for loan and lease losses and details of our provision for loan and lease losses and charge-offs by loan category for the three and six months ended June 30, 2011 and 2010.

Non-Interest Expense

Non-interest expense consists of ongoing operating costs, such as salaries and associated employee benefits, communications and other technology expenses, supplies and equipment, occupancy costs and miscellaneous expenses. Marketing expenses also are included in non-interest expense. Table 6 displays the components of non-interest expense for the three and six months ended June 30, 2011 and 2010.

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Table 6: Non-Interest Expense

(Dollars in millions)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Salaries and associated benefits	**$ 715**	$ 650	**$ 1,456**	$ 1,296
Marketing	**329**	219	**605**	399
Communications and data processing	**162**	164	**326**	333
Supplies and equipment	**124**	129	**259**	253
Occupancy	**118**	117	**237**	237
Other[(1)]	**807**	721	**1,534**	1,329
Total non-interest expense	**$ 2,255**	$ 2,000	**$ 4,417**	$ 3,847

(1) Consists of professional services expenses, credit collection costs, fee assessments and intangible amortization expense.

Non-interest expense of $2.3 billion for the second quarter of 2011 was up $255 million, or 13%, from the second quarter of 2010. Non-interest expense of $4.4 billion for the first six months of 2011 was up $570 million, or 15%, from the first six months of 2010. The increase was attributable to higher operating costs associated with increased purchase volumes and with the recent acquisitions of the Sony, HBC and Kohl s loan portfolios, higher legal fees and increased marketing costs. We have expanded our marketing efforts to attract and support targeted customers and new business volume through a variety of channels.

Income Taxes

Our effective tax rate may vary between periods due, in part, to fluctuations in our pre-tax earnings, which affects the relative tax benefit of tax-exempt income, tax credits and permanent tax items.

We recorded an income tax provision based on income from continuing operations of $450 million (32.3% effective income tax rate) in the second quarter of 2011, compared with an income tax provision of $369 million (31.2% effective income tax rate) in the second quarter of 2010, and $804 million (28.9% effective income tax rate) for the first six months of 2011 compared with $613 million (28.6% effective income tax rate) for the first six months of 2010.

We recorded tax benefits of $45 million and $50 million for the first six months of 2011 and 2010, respectively, related to the resolution of certain tax issues and audits, which lowered our effective income tax rate for those periods. Our effective income tax rate excluding the benefit from these discrete tax items was 30.5% and 30.9% for the first six months of 2011 and 2010, respectively.

We provide additional information on items affecting our income taxes and effective tax rate in our 2010 Form 10-K under Note 18 Income Taxes.

Loss from Discontinued Operations, Net of Tax

Loss from discontinued operations reflects ongoing costs, which primarily consist of mortgage loan repurchase representation and warranty charges, related to the mortgage origination operations of GreenPoint s wholesale mortgage banking unit, which we closed in 2007. We recorded a loss from discontinued operations, net of tax, of $34 million and $50 million in the second quarter and first six months of 2011, respectively. In comparison, we recorded a loss from discontinued operations, net of tax, of $204 million and $288 million in the second quarter and first six months of 2010, respectively.

The decrease in the loss from discontinued operations in the second quarter and first six months of 2011 was attributable to a significant reduction in the provision for mortgage repurchase losses. We recorded a pre-tax provision for mortgage repurchase losses of $37 million in the second quarter of 2011, of which $33 million ($22 million, net of tax) was included in discontinued operations, and a pre-tax provision of $81 million in the first six months of 2011, of which $72 million ($51 million, net of tax) was included in discontinued operations. In comparison, we recorded a pre-tax provision for mortgage repurchase losses of $404 million in the second quarter of 2010, of which $309 million ($212 million, net of tax) was included in discontinued operations, and a pre-tax provision of $628 million in the first six months of 2010, of which $433 million ($309 million, net of tax) was included in discontinued operations.

In the second quarter of 2010, we significantly increased our reserve for mortgage representation and warranty claims for legacy mortgage loans sold by our subsidiaries to various parties. The increase was primarily attributable to a refinement we made in estimating our reserve for representation and warranty claims to extend the timeframe, in most instances, over which we estimated our repurchase liability to the full life of the mortgage loans sold by our subsidiaries. We provide additional information on our reserve for representation and warranty claims in Consolidated Balance Sheet Analysis and Credit Performance Potential Mortgage Representation and Warranty Liabilities.

BUSINESS SEGMENT FINANCIAL PERFORMANCE

Our principal operations are currently organized into three major business segments, which are defined based on the products and services provided or the type of customer served: Credit Card, Consumer Banking and Commercial Banking. The operations of acquired businesses have been integrated into our existing business segments.

The results of our individual businesses, which we report on a continuing operations basis, reflect the manner in which management evaluates performance and makes decisions about funding our operations and allocating resources. Our business segment results are intended to reflect each segment as if it were a stand-alone business. We use an internal management and reporting process to derive our business segment results. Our internal management and reporting process employs various allocation methodologies, including funds transfer pricing, to assign certain balance sheet assets, deposits and other liabilities and their related revenue and expenses directly or indirectly attributable to each business segment. We may periodically change our business segments or reclassify business segment results based on modifications to our management reporting methodologies and changes in organizational alignment. See Note 20 Business Segments of our 2010 Form 10-K for information on the allocation methodologies used to derive our business segment results.

We summarize our business segment results for the three and six months ended June 30, 2011 and 2010 in the tables below and provide a comparative discussion of these results. We also discuss changes in our financial condition and credit performance statistics as of June 30, 2011, compared with December 31, 2010. See Note 14 Business Segments of this Report for a reconciliation of our business segment results to our consolidated U.S. GAAP results. Information on the outlook for each of our business segments is presented above under Executive Summary and Business Outlook.

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Credit Card Business

Our Credit Card business generated net income from continuing operations of $618 million and $1.3 billion in the second quarter and first six months of 2011, respectively, compared with net income from continuing operations of $568 million and $1.1 billion in the second quarter and first six months of 2010, respectively. The primary sources of revenue for our Credit Card business are net interest income and non-interest income from customer and interchange fees. Expenses primarily consist of ongoing operating costs, such as salaries and associated benefits, communications and other technology expenses, supplies and equipment, occupancy costs and marketing expenses.

Table 7 summarizes the financial results of our Credit Card business, which is comprised of the Domestic Card and International Card operations, and displays selected key metrics for the periods indicated. Our Credit Card business results for 2011 reflect the impact of the acquisitions of the existing portfolio credit card loan portfolios of Kohl s and HBC. The results related to the Kohl s loan portfolio, which totaled approximately $3.7 billion at acquisition on April 1, 2011, are included in our Domestic Card business. The results related to the HBC loan portfolio, which totaled approximately $1.4 billion at acquisition on January 7, 2011, are included in our International Card business.

Under the terms of the partnership agreement with Kohl s, we share a fixed percentage of revenues, consisting of finance charges and late fees, with Kohl s, and Kohl s is required to reimburse us for fixed percentage of credit losses incurred. Revenues and losses related to the Kohl s credit card program are reported on a net basis in our consolidated financial statements. The revenue sharing amounts earned by Kohl s are reflected as an offset against our revenues in our consolidated statements of income, which has the effect of reducing our net interest income and revenue margins. The loss sharing amounts from Kohl s are reflected as a reduction in our provision for loan and lease losses in our consolidated statements of income. We also report the related allowance for loan and lease losses attributable to the Kohl s portfolio in our consolidated balance sheets net of the loss sharing amount due from Kohl s.

Interest income was reduced by $215 million in the second quarter and first six months of 2011 for amounts earned by Kohl s. Loss sharing amounts attributable to Kohl s reduced charge-offs by $42 million in the second quarter and first six months of 2011. In addition, the expected reimbursement from Kohl s netted in our allowance for loan and lease losses was approximately $170 million as of June 30, 2011. The reduction in the provision for loan and lease losses attributable to Kohl s was $212 million for the second quarter and first six months of 2011.

We provide additional information on the acquisition of the existing credit card loan portfolios of Kohl s and HBC in Note 2 Acquisitions.

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Table 7: Credit Card Business Results

	Three Months Ended June 30,			Six Months Ended June 30,		
(Dollars in millions)	**2011**	**2010**	**Change**	**2011**	**2010**	**Change**
Selected income statement data:						
Net interest income	**$ 1,890**	$ 1,977	**(4)%**	**$ 3,831**	$ 4,090	**(6)%**
Non-interest income	**619**	659	**(6)**	**1,293**	1,377	**(6)**
Total revenue	**2,509**	2,636	**(5)**	**5,124**	5,467	**(6)**
Provision for loan and lease losses	**309**	765	**(60)**	**759**	1,940	**(61)**
Non-interest expense	**1,238**	1,002	**24**	**2,416**	1,916	**26**
Income from continuing operations before income taxes	**962**	869	**11**	**1,949**	1,611	**21**
Income tax provision	**344**	301	**14**	**688**	554	**24**
Income from continuing operations, net of tax	**$ 618**	$ 568	**9%**	**$ 1,261**	$ 1,057	**19%**
Selected performance metrics:						
Average loans held for investment	**$ 62,691**	$ 62,679	****%**	**$ 61,644**	$ 64,292	**(4)%**
Average yield on loans held for investment[1]	**13.83%**	14.67%	**(84)bps**	**14.25%**	14.78%	**(53)bps**
Revenue margin[2]	**16.01**	16.82	**(81)**	**16.62**	17.01	**(39)**
Net charge-off rate[3]	**5.06**	9.36	**(430)**	**5.59**	9.84	**(425)**
Purchase volume[4]	**$ 34,226**	$ 26,570	**29%**	**$ 62,023**	$ 50,494	**23%**

(Dollars in millions)	**June 30, 2011**	**December 31, 2010**	**Change**
Selected period-end data:			
Loans held for investment	**$ 62,705**	$ 61,371	**2%**
30+ day delinquency rate[5]	**3.60%**	4.29%	**(69)bps**
Allowance for loan and lease losses	**$ 3,093**	$ 4,041	**(23)%**

** Change is less than one percent.

(1) Average yield on loans held for investment is calculated by dividing annualized interest income for the period by average loans held for investment during the period. In preparing our Report on Form 10-Q for the first quarter of 2011 we determined that beginning in the second quarter of 2010, our management accounting processes excluded certain accounts that should have been included in the calculation of the average yield on loans held for investment. The mapping error was limited to the average yields on loans held for investment for our Credit Card business and had no impact on income statement amounts or the yields reported for any of our other business segments or for the total company. The revised average loan yields for our Credit Card business were 14.67%, 14.65%, 14.28% for the second quarter, third quarter and fourth quarter of 2010, respectively, and 14.78% for the six months ended June 30, 2010, 14.74% for the nine months ended September 30, 2010 and 14.63% for full year 2010. The previously reported average loan yields for our Credit Card business were 14.25%, 14.27%, 13.97% for the second quarter, third quarter and fourth quarter of 2010, respectively, and 14.57% for the six months ended June 30, 2010, 14.48% for the nine months ended September 30, 2010 and 14.36% for full year 2010.

(2) Revenue margin is calculated by dividing annualized revenues for the period by average loans held for investment during the period for the specified loan category.

(3) The net charge-off rate is calculated by loan category by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.

(4) Consists of purchase transactions for the period, net of returns. Excludes cash advance transactions.

(5) The delinquency rate is calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category. The 30+ day performing delinquency rate is the same as the 30+ day delinquency rate for our Credit Card business, as credit card loans remain on accrual status until the loan is charged-off.

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Key factors affecting the results of our Credit Card Banking business for the second quarter and first six months of 2011, compared with the second quarter and first six months of 2010 included the following.

Net Interest Income: Net interest income decreased by $87 million, or 4%, in the second quarter of 2011, reflecting the impact of a 4% decrease in the average yield on loans held for investment coupled with relatively stable average loan balances. The decrease in the average yield on loans was primarily driven by the impact from the addition of the Kohl s portfolio. The expected run-off of the installment loan portfolio and seasonal credit card balance paydowns resulted in a decrease in loan balances, which was offset by the addition of the HBC and Kohl s portfolios. Net interest income decreased by $259 million, or 6%, in the first six months of 2011, reflecting the impact of a 2% decrease in the average yield on loans held for investment and a 4% decrease in average loan balances. The decrease in the average yield in the first six months of 2011 was also due to a reduction in late fees and addition of the HBC and Kohl s portfolios. The expected run-off of the installment loan portfolio was the primary driver of the decline in average loan balances in the first six months of 2011, more than offsetting the impact of modest revolving card loan growth and the addition of the HBC and Kohl s portfolios.

Non-Interest Income: Non-interest income decreased by $40 million, or 6%, in the second quarter of 2011 and $84 million, or 6%, in the first six months of 2011. The decrease reflects the impact of contra-revenue amounts recorded in the second quarter of 2011, including a provision of $52 million for anticipated refunds to U.K. customers related to retrospective regulatory requirements pertaining to payment protection insurance (PPI) in our U.K. business and a provision of $21 million related to the periodic adjustment of our customer rewards points liability to reflect the estimated cost of points earned to date that are ultimately expected to be redeemed. These decreases were partially offset by higher interchange fees in the second quarter of 2011 resulting from increased purchase volume attributable to growth in our higher spend customer segments.

Provision for Loan and Lease Losses: The provision for loan and lease losses related to our Credit Card business decreased by $456 million in the second quarter of 2011, to $309 million and by $1.2 billion in the first six months of 2011, to $759 million. The significant reduction in the provision was primarily attributable to the continued improvement in underlying credit trends, including reduced delinquency rates, lower bankruptcy losses and higher recoveries. As estimated net charge-offs declined, we recorded an allowance release of $483 million and $948 million in the second quarter and first six months of 2011, respectively.

Non-Interest Expense: Non-interest expense increased by $236 million, or 24%, in the second quarter of 2011 and $500 million, or 26%, in the first six months of 2011. The increase was attributable to higher operating costs associated with increased purchase volumes and with the recent acquisitions of the Sony, HBC and Kohl s loan portfolios, higher legal fees and increased marketing costs. We have expanded our marketing efforts to attract and support targeted customers and new business volume through a variety of channels.

Total Loans: Period-end loans in the Credit Card business increased by $1.3 billion, or 2%, in the first six months of 2011, to $62.7 billion as of June 30, 2011, from $61.4 billion as of December 31, 2010. The increase was primarily attributable to the acquisitions of the Kohl s credit card portfolio of $3.7 billion and the HBC credit card portfolio of $1.4 billion, which were partially offset by the continued run-off of the installment loan portfolio and seasonal credit card balance paydowns.

Charge-off and Delinquency Statistics: Net charge-off and delinquency rates continued to improve in the second quarter and first six months of 2011. The net charge-off rate decreased to 5.06% and 5.59% in the second quarter and first six months of 2011, respectively, from 9.36% and 9.84% in the second quarter and first six months of 2010, respectively. The 30+ day delinquency rate decreased to 3.60% as of June 30, 2011, from 3.88% as of March 31, 2011 and 4.29% as of December 31, 2010. The improvement in net charge-off and delinquency rates reflects the impact of tighter underwriting standards since the recession.

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Domestic Credit Card Business

Table 7.1 summarizes the financial results for Domestic Card and displays selected key metrics for the periods indicated. Domestic Card accounted for 87% of total revenues for our Credit Card business in the second quarter of 2011 and 86% in the first six months of 2011, compared with 87% in both the second quarter and first six months of 2010. Because our Domestic Card business currently accounts for the substantial majority of our Credit Card business, the key factors driving the results for this division are similar to the key factors affecting our total Credit Card business.

Table 7.1: Domestic Card Business Results

	Three Months Ended June 30,			Six Months Ended June 30,		
(Dollars in millions)	**2011**	**2010**	**Change**	**2011**	**2010**	**Change**
Selected income statement data:						
Net interest income	**$ 1,607**	$ 1,735	**(7)%**	**$ 3,258**	$ 3,600	**(10)%**
Non-interest income	**584**	560	**4**	**1,167**	1,178	**(1)**
Total revenue	**2,191**	2,295	**(5)**	**4,425**	4,778	**(7)**
Provision for loan and lease losses	**187**	675	**(72)**	**417**	1,771	**(76)**
Non-interest expense	**1,008**	869	**16**	**1,998**	1,678	**19**
Income from continuing operations before income taxes	**996**	751	**33**	**2,010**	1,329	**51**
Income tax provision	**354**	268	**32**	**714**	474	**51**
Income from continuing operations, net of tax	**$ 642**	$ 483	**33%**	**$ 1,296**	$ 855	**52%**
Selected performance metrics:						
Average loans held for investment	**$ 53,868**	$ 55,252	**(3)%**	**$ 52,884**	$ 56,672	**(7)%**
Average yield on loans held for investment[1]	**13.52%**	14.49%	**(97)bps**	**13.96%**	14.64%	**(68)bps**
Revenue margin[2]	**16.27**	16.61	**(34)**	**16.73**	16.86	**(13)**
Net charge-off rate[3]	**4.74**	9.49	**(475)**	**5.45**	10.00	**(455)**
Purchase volume[4]	**$ 31,070**	$ 24,513	**27%**	**$ 56,094**	$ 46,501	**21%**

(Dollars in millions)	**June 30, 2011**	**December 31, 2010**	**Change**
Selected period-end data:			
Loans held for investment	**$ 53,994**	$ 53,849	****%**
30+ day delinquency rate[5]	**3.33%**	4.09%	**(76)bps**
Allowance for loan and lease losses	**$ 2,555**	$ 3,581	**(29)%**

** Change is less than one percent.

(1) Average yield on loans held for investment is calculated by dividing annualized interest income for the period by average loans held for investment during the period. As indicated above, in preparing our Report on Form 10-Q for the first quarter of 2011, we determined that beginning in the second quarter of 2010, our management accounting processes excluded certain accounts that affected the calculation of the average yield on loans held for investment for our Credit Card business. The revised average loan yields for our Domestic Credit Card business were 14.49%, 14.40%, 13.96% for the second quarter, third quarter and fourth quarter of 2010, respectively, and 14.64% for the six months ended June 30, 2010, 14.57% for the nine months ended September 30, 2010 and 14.42% for full year 2010. The previously reported average loan yields for our Domestic Credit Card business were 13.98%, 13.95%, 13.57% for the second quarter, third quarter and fourth quarter of 2010, respectively, and 14.39% for the six months ended June 30, 2010, 14.25% for the nine months ended September 30, 2010 and 14.09% for full year 2010.

(2) Revenue margin is calculated by dividing annualized revenues for the period by average loans held for investment during the period for the specified loan category.

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(3) The net charge-off rate is calculated by loan category by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.
(4) Consists of purchase transactions for the period, net of returns. Excludes cash advance transactions.
(5) The delinquency rate is calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category. The 30+ day performing delinquency rate is the same as the 30+ day delinquency rate for our Credit Card business, as credit card loans remain on accrual status until the loan is charged-off.

Our Domestic Card division generated net income from continuing operations of $642 million and $1.3 billion in the second quarter and first six months of 2011, respectively, compared with net income from continuing operations of $483 million and $855 million in the second quarter and first six months of 2010, respectively.

The primary factors affecting Domestic Card results for the second quarter and the first six months of 2011, compared with the second quarter and the first six months of 2010 include: (1) a decline in total revenue attributable to a decrease in average loan yields as a result of reduced fees and the impact of the addition of the Kohl s loan portfolio and lower average loan balances; (2) a significant reduction in the provision for loan and lease losses due to the continued improvement in credit performance metrics, including decreases in delinquency and charge-off rates; and (3) an increase in non-interest expense attributable to increased operating costs associated with higher purchase volumes and with the acquisitions of the Sony and Kohl s loan portfolios, higher legal expenses and increased marketing expenditures.

International Credit Card Business

Table 7.2 summarizes the financial results for International Card and displays selected key metrics for the periods indicated. International Card accounted for 13% of total revenues for our Credit Card business in the second quarter of 2011 and 14% in the first six months of 2011, compared with 13% in both the second quarter and first six months of 2010.

Table 7.2: International Card Business Results

	Three Months Ended June 30,			Six Months Ended June 30,		
(Dollars in millions)	**2011**	**2010**	**Change**	**2011**	**2010**	**Change**
Selected income statement data:						
Net interest income	**$ 283**	$ 242	**17%**	**$ 573**	$ 490	**17%**
Non-interest income	**35**	99	**(65)**	**126**	199	**(37)**
Total revenue	**318**	341	**(7)**	**699**	689	**1**
Provision for loan and lease losses	**122**	90	**36**	**342**	169	**102**
Non-interest expense	**230**	133	**73**	**418**	238	**76**
Income from continuing operations before income taxes	**(34)**	118	**(129)**	**(61)**	282	**(122)**
Income tax provision	**(10)**	33	**(130)**	**(26)**	80	**(133)**
Income from continuing operations, net of tax	**$ (24)**	$ 85	**(128)%**	**$ (35)**	$ 202	**(117)%**
Selected performance metrics:						
Average loans held for investment	**$ 8,823**	$ 7,427	**19%**	**$ 8,760**	$ 7,620	**15%**
Average yield on loans held for investment(1)	**15.77%**	16.00%	**(23)bps**	**16.02%**	15.83%	**19bps**
Revenue margin(2)	**14.42**	18.37	**(395)**	**15.96**	18.09	**(213)**
Net charge-off rate(3)	**7.02**	8.38	**(136)**	**6.39**	8.61	**(222)**
Purchase volume(4)	**$ 3,156**	$ 2,057	**53%**	**$ 5,929**	$ 3,993	**48%**

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(Dollars in millions)	June 30, 2011	December 31, 2010	Change
Selected period-end data:			
Loans held for investment	**$ 8,711**	$ 7,522	**16%**
30+ day delinquency rate[5]	**5.30%**	5.75%	**(45)bps**
Allowance for loan and lease losses	**$ 538**	$ 460	**17%**

(1) Average yield on loans held for investment is calculated by dividing annualized interest income for the period by average loans held for investment during the period. As indicated above, in preparing our Report on Form 10-Q for the first quarter of 2011, we determined that beginning in the second quarter of 2010, our management accounting processes excluded certain accounts that affected the calculation of the average yield on loans held for investment for our Credit Card business. The revised average loan yields for our International Credit Card business were 16.00%, 16.40%, 16.61% for the second quarter, third quarter and fourth quarter of 2010, respectively, and 15.83% for the six months ended June 30, 2010, 16.02% for the nine months ended September 30, 2010 and 16.16% for full year 2010. The previously reported average loan yields for our International Credit Card business were 16.21%, 16.62%, 16.82% for the second quarter, third quarter and fourth quarter of 2010, respectively, and 15.93% for the six months ended June 30, 2010, 16.16% for the nine months ended September 30, 2010 and 16.33% for full year 2010.

(2) Revenue margin is calculated by dividing annualized revenues for the period by average loans held for investment during the period for the specified loan category.

(3) The net charge-off rate is calculated by loan category by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category.

(4) Consists of purchase transactions for the period, net of returns. Excludes cash advance transactions.

(5) The delinquency rate is calculated by loan category by dividing delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category. The 30+ day performing delinquency rate is the same as the 30+ day delinquency rate for our Credit Card business, as credit card loans remain on accrual status until the loan is charged-off.

Our International Card division generated a net loss from continuing operations of $24 million and $35 million in the second quarter and first six months of 2011, respectively, compared with net income from continuing operations of $85 million and $202 million in the second quarter and first six months of 2010, respectively.

The primary factors contributing to the International Card net losses in the second quarter and the first six months of 2011, compared with net income in the second quarter and the first six months of 2010 include: (1) a decrease in non-interest income due to the contra-revenue provision of $52 million recorded in the second quarter of 2011 for the anticipated refunds to U.K. customers related to retrospective regulatory requirements pertaining to PPI insurance in our U.K. business; (2) an increase in the provision for loan losses due to the addition of the HBC loan portfolio and lower allowance releases relative to the same prior year periods; and (3) an increase in non-interest expense attributable to increased operating costs associated with HBC associates who joined us as a result of the acquisition. These factors were partially offset by an increase in non-interest income attributable to higher loan balances.

Consumer Banking Business

Our Consumer Banking business generated net income from continuing operations of $287 million and $502 million in the second quarter and first six months of 2011, respectively, compared with $305 million and $610 million in the second quarter and first six months of 2010, respectively. The primary sources of revenue for our Consumer Banking business are net interest income from loans and deposits and non-interest income from customer fees. Expenses primarily consist of ongoing operating costs, such as salaries and associated benefits, communications and other technology expenses, supplies and equipment and occupancy costs.

Table 8 summarizes the financial results of our Consumer Banking business and displays selected key metrics for the periods indicated.

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Table 8: Consumer Banking Business Results

(Dollars in millions)	Three Months Ended June 30, 2011	2010	Change	Six Months Ended June 30, 2011	2010	Change
Selected income statement data:						
Net interest income	**$ 1,051**	$ 935	**12%**	**$ 2,034**	$ 1,831	**11%**
Non-interest income	**194**	162	**20**	**380**	478	**(21)**
Total revenue	**1,245**	1,097	**13**	**2,414**	2,309	**5**
Provision for loan and lease losses	**41**	(112)	**137**	**136**	(62)	**319**
Non-interest expense	**758**	735	**3**	**1,498**	1,423	**5**
Income from continuing operations before income taxes	**446**	474	**(6)**	**780**	948	**(18)**
Income tax provision	**159**	169	**(6)**	**278**	338	**(18)**
Income from continuing operations, net of tax	**$ 287**	$ 305	**(6)%**	**$ 502**	$ 610	**(18)%**
Selected performance metrics:						
Average loans held for investment:						
Auto	**$ 18,753**	$ 17,276	**9%**	**$ 18,391**	$ 17,521	**5%**
Home loan	**11,534**	13,573	**(15)**	**11,746**	14,531	**(19)**
Retail banking	**4,154**	4,811	**(14)**	**4,202**	4,926	**(15)**
Total consumer banking	**$ 34,441**	$ 35,660	**(3)%**	**$ 34,339**	$ 36,978	**(7)%**
Average yield on loans held for investment	**9.51%**	8.99%	**52bps**	**9.55%**	8.97%	**58bps**
Average deposits	**$ 86,926**	$ 77,082	**13%**	**$ 85,413**	$ 76,104	**12%**
Average deposit interest rate	**1.00%**	1.18%	**(18)bps**	**1.03%**	1.23%	**(20)bps**
Core deposit intangible amortization	**$ 34**	$ 36	**(6)%**	**$ 68**	$ 74	**(8)%**
Net charge-off rate[(1)(2)]	**1.01%**	1.47%	**(46)bps**	**1.29%**	1.76%	**(47)bps**
Automobile loan originations	**$ 2,910**	$ 1,765	**65%**	**$ 5,481**	$ 3,108	**76%**

(Dollars in millions)	June 30, 2011	December 31, 2010	Change
Selected period-end data:			
Loans held for investment:			
Auto	**$ 19,223**	$ 17,867	**8%**
Home loans	**11,323**	12,103	**(6)**
Retail banking	**4,046**	4,413	**(8)**
Total consumer banking	**$ 34,592**	$ 34,383	**1%**
30+ day performing delinquency rate[(1)(3)]	**3.70%**	4.28%	**(58)bps**
30+ day delinquency rate[(1)(3)]	**5.26**	5.96	**(70)**
Nonperforming loan rate[(1)(4)]	**1.83**	1.97	**(14)**
Nonperforming asset rate[(1)(5)]	**2.00**	2.17	**(17)**
Allowance for loan and lease losses	**$ 598**	$ 675	**(11)%**
Deposits	**87,282**	82,959	**5**
Loans serviced for others	**19,226**	20,689	**(7)**

(1) Average loans held for investment used in the denominator in calculating net charge-off, delinquency and nonperforming loan and nonperforming asset rates includes the impact of loans acquired as part of the Chevy Chase Bank acquisition, which were considered purchased credit impaired (PCI) loans. However, we separately track and report PCI loans and exclude these loans from our net charge-off, delinquency, nonperforming loan and nonperforming asset rates.

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(2) The net charge-off rate is calculated by loan category by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category. The net charge-off rate, excluding loans acquired from Chevy Chase Bank from the denominator, was 1.17% and 1.76% for the three months ended June 30, 2011 and 2010, respectively, and 1.50% and 2.10% for the six months ended June 30, 2011 and 2010, respectively.

(3) The delinquency rate is calculated by loan category by dividing delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category. The 30+ day performing delinquency rate, excluding loans acquired from Chevy Chase Bank from the denominator, was 4.29% as of June 30, 2011 and 5.01% as of December 31, 2010. The 30+ day delinquency rate, excluding loans acquired from Chevy Chase Bank from the denominator, was 6.09% as of June 30, 2011 and 6.98% as of December 31, 2010.

(4) Nonperforming loans generally include loans that have been placed on nonaccrual status and certain restructured loans whose contractual terms have been restructured in a manner that grants a concession to a borrower experiencing financial difficulty. The nonperforming loan rate is calculated by loan category by dividing nonperforming loans as of the end of the period by period-end loans held for investment for the specified loan category. The nonperforming loan rate, excluding the impact of loans acquired from Chevy Chase Bank from the denominator, was 2.12% and 2.30% as of June 30, 2011 and December 31, 2010, respectively.

(5) Nonperforming assets consist of nonperforming loans and real estate owned (REO). The nonperforming asset rate is calculated by loan category by dividing nonperforming assets as of the end of the period by period-end loans held for investment and REO for the specified loan category. The nonperforming asset rate, excluding loans acquired from Chevy Chase Bank from the denominator, was 2.32% and 2.54% as of June 30, 2011 and December 31, 2010, respectively.

Key factors affecting the results of our Consumer Banking business for the second quarter and first six months of 2011, compared with the second quarter of 2010 included the following:

Net Interest Income: Net interest income increased by $116 million, or 12%, in the second quarter of 2011, and $203 million, or 11%, in the first six months of 2011. The primary drivers of the increase in net interest income were improved loan margins, primarily resulting from higher pricing for new auto loan originations and lower interest expense associated with deposit growth resulting from our continued strategy to leverage our banking branches to attract lower cost funding sources. In addition, better than expected performance of PCI loans related to our Chevy Chase Bank acquisition resulted in an increase in the accretion of amounts into income. The favorable impact from these factors more than offset the decline in average loans held for investment resulting from the continued run-off of home loans.

Non-Interest Income: Non-interest income increased by $32 million, or 20%, in the second quarter of 2011 and decreased by $98 million, or 21%, in the first six months of 2011. The increase in non-interest income in the second quarter of 2011 from the same prior year period was primarily due to the absence of an impairment charge on mortgage servicing rights recorded in the second quarter of 2010. The decrease in non-interest income in the first six months of 2011 from the same prior year period was primarily attributable to the combined impact of the absence of a net gain of $128 million recorded in the first quarter of 2010 related to the deconsolidation of certain option-adjustable rate mortgage trusts that were consolidated on January 1, 2010 as a result of our adoption of the new consolidation accounting standards and the absence of the impairment charge on mortgage servicing rights recorded in the second quarter of 2010.

Provision for Loan and Lease Losses: The provision for loan and lease losses increased by $153 million in the second quarter of 2011, to $41 million and by $198 million in the first six months of 2011, to $136 million. Although we experienced continued improvement in credit performance in our Consumer Banking business, including reduced delinquency and net charge-off rates, we recorded a higher provision for loan and lease losses in the second quarter and first six months of 2011 relative to the same prior year periods due to a reduction in allowance releases and growth in our auto loan portfolio.

Non-Interest Expense: Non-interest expense increased by $23 million, or 3%, in the second quarter and by $75 million, or 5%, in the first six months of 2011. The increases over the same prior year periods were largely attributable to higher infrastructure expenditures due to increased headcount and increased marketing expenditures, primarily related to our retail banking operations.

Total Loans: Period-end loans in the Consumer Banking business increased by $209 million, or less than 1%, in the first six months of 2011, to $34.6 billion as of June 30, 2011, from $34.4 billion as of December 31, 2010, primarily due to growth in auto loans that was partially offset by continued run-off of home loans.

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Deposits: Period-end deposits in the Consumer Banking business increased by $4.3 billion, or 5%, in the first six months of 2011, to $87.3 billion as of June 30, 2011, reflecting the impact of our strategy to replace maturing higher cost wholesale funding sources with lower cost funding sources and our increased retail marketing efforts to attract new business to meet this objective.

Charge-off and Delinquency Statistics: The net charge-off rate decreased to 1.01% and 1.29% in the second quarter and first six months of 2011, respectively, from 1.47% and 1.76% in the second quarter and first six months of 2010, respectively. The 30+ day delinquency rate was 5.26% as of June 30, 2011, compared to 4.96% as of March 31, 2011 and 5.96% as of December 31, 2010. The improvement in the net charge-off and delinquency rates reflects the impact from strong underlying credit performance trends and the higher credit quality of our more recent auto loan vintages, as well as current favorable benefits from elevated auction prices.

Commercial Banking Business

Our Commercial Banking business generated net income from continuing operations of $142 million and $290 million for the second quarter and first six months of 2011, respectively, compared with a net income from continuing operations of $77 million and $28 million in the second quarter and first six months of 2010, respectively. The primary sources of revenue for our Commercial Banking business are net interest income from loans and deposits and non-interest income from customer fees. Expenses primarily consist of ongoing operating costs, such as salaries and associated benefits, communications and other technology expenses, supplies and equipment and occupancy costs.

Table 9 summarizes the financial results of our Commercial Banking business and displays selected key metrics for the periods indicated.

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Table 9: Commercial Banking Business Results

	Three Months Ended June 30,			Six Months Ended June 30,		
(Dollars in millions)	**2011**	**2010**	**Change**	**2011**	**2010**	**Change**
Selected income statement data:						
Net interest income	**$ 333**	$ 319	**4%**	**$ 654**	$ 631	**4%**
Non-interest income	**62**	60	**3**	**133**	102	**30**
Total revenue	**395**	379	**4**	**787**	733	**7**
Provision for loan and lease losses	**(18)**	62	**(129)**	**(33)**	300	**(89)**
Non-interest expense	**192**	198	**(3)**	**369**	390	**(5)**
Income from continuing operations before income taxes	**221**	119	**86**	**451**	43	**949**
Income tax provision	**79**	42	**88**	**161**	15	**973**
Income from continuing operations, net of tax	**$ 142**	$ 77	**84%**	**$ 290**	$ 28	**936%**
Selected performance metrics:						
Average loans held for investment:						
Commercial and multifamily real estate	**$ 13,597**	$ 13,543	****%**	**$ 13,472**	$ 13,629	**(1)%**
Middle market	**10,979**	10,276	**7**	**10,823**	10,300	**5**
Specialty lending	**4,014**	3,654	**10**	**3,989**	3,632	**10**
Total commercial lending	**28,590**	27,473	**4**	**28,284**	27,561	**3**
Small-ticket commercial real estate	**1,726**	2,060	**(16)**	**1,772**	2,067	**(14)**
Total commercial banking	**$ 30,316**	$ 29,533	**3%**	**$ 30,056**	$ 29,628	**1%**
Average yield on loans held for investment	**4.74%**	4.94%	**(20)bps**	**4.77%**	4.99%	**(22)bps**
Average deposits	**$ 24,282**	$ 22,171	**10%**	**$ 24,210**	$ 22,016	**10%**
Average deposit interest rate	**0.52%**	0.67%	**(15)bps**	**0.53%**	0.71%	**(18)bps**
Core deposit intangible amortization	**$ 10**	$ 14	**(29)%**	**$ 21**	$ 28	**(25)%**
Net charge-off rate(1)(2)	**0.50%**	1.21%	**(71)bps**	**0.64%**	1.29%	**(65)bps**

(Dollars in millions)	**June 30, 2011**	**December 31, 2010**	**Change**
Selected period-end data:			
Loans held for investment:			
Commercial and multifamily real estate	**$ 14,035**	$ 13,396	**5%**
Middle market	**11,404**	10,484	**9**
Specialty lending	**4,122**	4,020	**3**
Total commercial lending	**29,561**	27,900	**6**
Small-ticket commercial real estate	**1,642**	1,842	**(11)**
Total commercial banking	**$ 31,203**	$ 29,742	**5%**
Nonperforming loan rate(1)(3)	**1.54%**	1.66%	**(12)bps**
Nonperforming asset rate(1)(4)	**1.66**	1.80	**(14)**
Allowance for loan and lease losses	**$ 730**	$ 826	**(12)%**
Deposits	**24,304**	22,630	**7**

** Change is less than one percent.

(1) Average loans held for investment used in the denominator in calculating net charge-off, delinquency and nonperforming loan and nonperforming asset rates includes the impact of loans acquired as part of the Chevy Chase Bank acquisition, which were considered purchased credit impaired (PCI) loans. However, we separately track and report PCI loans and exclude these loans from our net charge-off, delinquency, nonperforming loan and nonperforming asset rates.

(2) The net charge-off rate is calculated by loan category by dividing annualized net charge-offs for the period by average loans held for investment during the period for the specified loan category. The net charge-off rate, excluding loans

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acquired from Chevy Chase Bank from the denominator, was 0.51% and 1.24% for the three months ended June 30, 2011 and 2010, respectively, and 0.65% and 1.33% for the six months ended June 30, 2011 and 2010, respectively.

(3) The nonperforming loan rate is calculated by loan category by dividing nonperforming loans as of the end of the period by period-end loans held for investment for the specified loan category. The nonperforming loan rate, excluding the impact of loans acquired from Chevy Chase Bank from the denominator, was 1.56% and 1.69% as of June 30, 2011 and December 31, 2010, respectively.

(4) The nonperforming asset rate is calculated by loan category by dividing nonperforming assets as of the end of the period by period-end loans held for investment and REO for the specified loan category. The nonperforming asset rate, excluding loans acquired from Chevy Chase Bank from the denominator, was 1.68% and 1.83% as of June 30, 2011 and December 31, 2010, respectively.

Key factors affecting the results of our Commercial Banking business for the second quarter and first six months of 2011, compared with the second quarter and first six months of 2010 included the following:

Net Interest Income: Net interest income increased by $14 million, or 4%, in the second quarter of 2011, and by $23 million, or 4%, in the first six months of 2011. The primary drivers of the increase in net interest income from the same prior year periods were lower interest expense associated with strong deposit growth resulting from our continued strategy to shift our funding mix to lower cost commercial banking deposits from higher cost wholesale sources, more favorable deposit pricing resulting from the repricing of higher rate deposits to lower rates in response to the overall lower interest rate environment and commercial loan growth.

Non-Interest Income: Non-interest income increased by $2 million, or 3%, in the second quarter of 2011 and $31 million, or 30%, in the first six months of 2011. The increase in non-interest income from the same prior year periods was largely attributable to growth in fees in the middle market segment, as well as increased customer fees related to treasury management and public financing activities.

Provision for Loan and Lease Losses: The Commercial Banking business recorded a negative provision for loan and lease losses of $18 million and $33 million in the second quarter and first six months of 2011, respectively, compared with provision expense of $62 million and $300 million in the second quarter and first six months of 2010, respectively. The negative provision in the second quarter and first six months of 2011 was attributable to lower loss severities resulting from an improvement in underlying credit performance trends. As a result, we reduced the allowance related to the Commercial Banking business by $52 million and $96 million in the second quarter and first six months of 2011, respectively. In comparison, we reduced the allowance by $36 million in the second quarter of 2010 and increased the allowance by $97 million in the first six months of 2010.

Non-Interest Expense: Non-interest expense decreased by $6 million, or 3%, in the second quarter of 2011 to $192 million and by $21 million, or 5%, in the first six months of 2011 to $369 million. The decreases from the same prior year periods were attributable to a reduction in the integration costs related to the Chevy Chase Bank acquisition incurred in the first six months of 2010.

Total Loans: Period-end loans increased by $1.5 billion, or 5%, in the first six months of 2011 to $31.2 billion as of June 30, 2011, from $29.7 billion as of December 31, 2010. The increase was driven by stronger loan demand in the middle market and commercial real estate businesses, which was partially offset by attrition in our multifamily real estate portfolio and the run-off and sale of a portion of the small-ticket commercial real estate loan portfolio.

Deposits: Period-end deposits in the Commercial Banking business increased by $1.7 billion, or 7%, in the first six months of 2011, to $24.3 billion as of June 30, 2011, driven by our increased effort to build and expand commercial relationships and attract lower cost funding sources.

Charge-off and Nonperforming Loan Statistics: The net charge-off rate decreased to 0.50% and 0.64% in the second quarter and first six months of 2011, respectively, from 1.21% and 1.29% in the second quarter and first six months of 2010, respectively. The nonperforming loan rate decreased to 1.54% as of June 30, 2011, from 1.66% as of December 31, 2010. The improvement in the net charge-off and nonperforming loan rates was attributable to strong underlying credit improvement trends.

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CONSOLIDATED BALANCE SHEET ANALYSIS AND CREDIT PERFORMANCE

Total assets of $199.8 billion as of June 30, 2011 increased by $2.3 billion, or 1%, from $197.5 billion as of December 31, 2010. Total liabilities of $171.1 billion as of June 30, 2011, increased by $110 million, or less than 1%, from $171.0 billion as of December 31, 2010. Stockholders equity increased by $2.1 billion during the first six months of 2011, to $28.7 billion as of June 30, 2011 from $26.5 billion as of December 31, 2010. The increase in stockholders equity was primarily attributable to our net income of $1.9 billion in the first six months of 2011.

Following is a discussion of material changes in the major components of our assets and liabilities during the first six months of 2011.

Investment Securities

Our investment securities portfolio, which had a fair value of $39.5 billion and $41.5 billion, as of June 30, 2011 and December 31, 2010, respectively, consists of the following: U.S. Treasury and U.S. agency debt obligations; agency and non-agency mortgage-backed securities; other asset-backed securities collateralized primarily by credit card loans, auto loans, student loans, auto dealer floor plan inventory loans and leases, equipment loans and home equity lines of credit; municipal securities; and limited Community Reinvestment Act (CRA) equity securities. Our investment securities portfolio continues to be heavily concentrated in securities that generally have lower credit risk and high credit ratings, such as securities issued and guaranteed by the U.S. Treasury and government sponsored enterprises or agencies. Our investments in U.S. Treasury and agency securities, based on fair value, represented approximately 71% and 70% of our total investment securities portfolio as of June 30, 2011, and December 31, 2010, respectively.

All of our investment securities were classified as available for sale as of June 30, 2011 and December 31, 2010, and reported in our consolidated balance sheet at fair value. Table 10 presents the amortized cost and fair value of our investment securities, by investment type, as of June 30, 2011 and December 31, 2010.

Table 10: Investment Securities

	June 30, 2011		December 31, 2010	
(Dollars in millions)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Treasury debt obligations	**$ 301**	**$ 311**	$ 373	$ 386
U.S. Agency debt obligations(1)	**166**	**176**	301	314
Collateralized mortgage obligations (CMO):				
Agency(2)	**12,104**	**12,412**	12,303	12,566
Non-agency	**953**	**889**	1,091	1,019
Total CMOs	**13,057**	**13,301**	13,394	13,585
Mortgage-backed securities (MBS):				
Agency(2)	**14,344**	**14,733**	15,721	15,983
Non-agency	**630**	**573**	735	681
Total MBS	**14,974**	**15,306**	16,456	16,664
Asset-backed securities (ABS(3))	**9,769**	**9,832**	9,901	9,966
Other securities(4)	**489**	**548**	563	622
Total securities available for sale	**$ 38,756**	**$ 39,474**	$ 40,988	$ 41,537

(1) Consists of debt securities issued by Fannie Mae and Freddie Mac with an amortized cost of $165 million and $200 million, as of June 30, 2011 and December 31, 2010, respectively, and fair value of $175 million and $213 million, as of June 30, 2011 and December 31, 2010, respectively.

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(2) Consists of mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae with an amortized cost of $15.5 billion, $7.7 billion and $3.2 billion, respectively, and fair value of $15.9 billion, $7.9 billion and $3.3 billion, respectively, as of June 30, 2011. The book value of Fannie Mae, Freddie Mac and Ginnie Mae investments each exceeded 10% of our stockholders equity as of June 30, 2011.

(3) Consists of securities collateralized by credit card loans, auto dealer floor plan inventory loans and leases, student loans, auto loans, equipment loans and other. The distribution among these asset types was approximately 71.0% credit card loans, 9.3% auto dealer floor plan inventory loans and leases, 6.9% student loans, 6.6% auto loans, 1.9% equipment loans, and 4.3% of other loans as of June 30, 2011. In comparison, the distribution was approximately 77.8% credit card loans, 5.6% auto dealer floor plan inventory loans and leases, 7.2% student loans, 6.7% auto loans, 2.5% equipment loans and 0.2% home equity lines of credit as of December 31, 2010. Approximately 91.7% of the securities in our asset-backed security portfolio were rated AAA or its equivalent as of June 30, 2011, compared with 90.1% as of December 31, 2010. Our asset-backed security portfolio also includes commercial mortgage-backed securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae with an amortized cost of $8 million, $158 million and $55 million, respectively, and fair values of $9 million, $161 million and $56 million, respectively, as of June 30, 2011.

(4) Consists of municipal securities and equity investments, primarily related to CRA activities.

Unrealized gains and losses on our available-for-sale securities are recorded net of tax as a component of accumulated other comprehensive income (AOCI). We had gross unrealized gains of $914 million and gross unrealized losses of $196 million on available-for-sale securities as of June 30, 2011, compared with gross unrealized gains of $830 million and gross unrealized losses of $281 million as of December 31, 2010. Of the $196 million in gross unrealized losses as of June 30, 2011, $124 million related to securities that had been in a loss position for more than 12 months.

We evaluate available-for-sale securities in an unrealized loss position as of the end of each quarter for other-than-temporary impairment (OTTI) based on a number of criteria, including the extent and duration of the decline in value, the severity and duration of the impairment, recent events specific to the issuer and/or industry to which the issuer belongs, the payment structure of the security, external credit ratings, the failure of the issuer to make scheduled interest or principal payments, the value of underlying collateral, our intent and ability to hold the security and current market conditions. We recognized net OTTI on investment securities of $6 million and $9 million in the second quarter and first six months of 2011, respectively. In comparison, we recognized net OTTI on investment securities of $26 million and $57 million in the second quarter and first six months of 2010, respectively, which was due in part to our decision to sell certain other securities before recovery of the impairment amount as well as the deterioration in the credit performance of certain non-agency mortgage-related securities resulting from weaknesses in the housing market and high unemployment.

We provide additional information on our available-for-sale securities and OTTI assessment in Note 4 Investment Securities.

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Total Loans

Table 11 presents the composition of our total loan portfolio, by business segments, as of June 30, 2011 and December 31, 2010:

Table 11: Loan Portfolio Composition

	June 30, 2011		December 31, 2010	
(Dollars in millions)	Amount	% of Total Loans	Amount	% of Total Loans
Credit Card business:				
Credit card loans:				
Domestic credit card loans	**$ 51,236**	**39.7%**	$ 49,979	39.7%
International credit card loans	**8,709**	**6.8**	7,513	6.0
Total credit card loans	**59,945**	**46.5**	57,492	45.7
Installment loans:				
Domestic installment loans	**2,758**	**2.1**	3,870	3.0
International installment loans	**2**		9	
Total installment loans	**2,760**	**2.1**	3,879	3.0
Total credit card	**62,705**	**48.6**	61,371	48.7
Consumer Banking business:				
Automobile	**19,223**	**14.9**	17,867	14.2
Home loan	**11,323**	**8.8**	12,103	9.6
Retail banking	**4,046**	**3.1**	4,413	3.5
Total consumer banking	**34,592**	**26.8**	34,383	27.3
Commercial Banking business:				
Commercial and multifamily real estate[1]	**14,035**	**10.9**	13,396	10.6
Middle market	**11,404**	**8.8**	10,484	8.3
Specialty lending	**4,122**	**3.2**	4,020	3.2
Total commercial lending	**29,561**	**22.9**	27,900	22.1
Small-ticket commercial real estate	**1,642**	**1.3**	1,842	1.5
Total commercial banking	**31,203**	**24.2**	29,742	23.6
Other:				
Other loans	**465**	**0.4**	451	0.4
Total loans	**$ 128,965**	**100.0%**	$ 125,947	100.0%

(1) Includes construction and land development loans totaling $2.1 billion and $2.4 billion as of June 30, 2011 and December 31, 2010, respectively.

Total loans increased by $3.0 billion, or 2%, to $129.0 billion as of June 30, 2011, from $125.9 billion as of December 31, 2010. The increase was primarily attributable to the acquisitions of the Kohl s portfolio of $3.7 billion and the HBC portfolio of $1.4 billion, strong growth in purchase volume across our Domestic Card business and growth in both Auto Finance and Commercial Banking loans. Excluding the impact of the Kohl s and HBC acquisitions, total loans decreased by $2.1 billion, or 2%, in the first six months of 2011. The decrease was attributable to the continued expected run-off of loans in businesses we exited or repositioned early in the economic recession, other loan paydowns and charge-offs, which more than offset the strong growth in purchase volume across the Domestic Card business. The run-off portfolios include installment loans in our Credit Card business, home loans in our Consumer Banking business and small-ticket commercial real estate loans in our Commercial Banking business.

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Credit Performance

We closely monitor economic conditions and loan performance trends to manage and evaluate our exposure to credit risk. Trends in delinquency ratios are an indicator, among other considerations, of credit risk within our loan portfolios. The level of nonperforming assets represents another indicator of the potential for future credit losses. Accordingly, key metrics we track and use in evaluating the credit quality of our loan portfolio include delinquency and nonperforming asset rates, as well as charge-off rates and our internal risk ratings of commercial loans. We experienced an improvement in credit performance across all of our businesses during the second quarter and first six months of 2011, including reduced delinquency rates, average loss severities and charge-off rates. We present information in the section below on the credit performance of our loan portfolio, including the key metrics we use in tracking changes in the credit quality of our loan portfolio. See Note 5 Loans for additional information.

Delinquency Rates

We consider the entire balance of an account to be delinquent if the minimum required payment is not received by the first statement cycle date equal to or following the due date specified on the customer s billing statement. Table 12 below compares 30+ day performing loan delinquency rates, by loan category, as of June 30, 2011 and December 31, 2010. We also present total 30+ day delinquent loans.

Our 30+ day delinquency metrics include all held for investment loans that are 30 or more days past due, whereas our 30+ day performing delinquency metrics include loans that are 30 or more days past due and that are also currently classified as performing and accruing interest. The 30+ day delinquency and 30+ day performing delinquency metrics are the same for credit card loans, as we continue to classify credit card loans as performing until they are charged-off, generally when the loan is 180 days past due. However, the 30+ day delinquency and 30+ day performing delinquency metrics differ for other loan categories based on our policies for classifying loans as nonperforming. See Note 5 Loans for additional information on our policies for classifying loans as nonperforming and for charging-off loans.

The delinquency rates presented are calculated, by loan category, based on our total loan portfolio. Our total loan portfolio consists of loans recorded on our balance sheet, which includes purchased credit impaired (PCI) loans acquired from Chevy Chase Bank, and loans held in our securitization trusts. Loans acquired from Chevy Chase Bank were recorded at fair value at acquisition. We separately track and report the performance of PCI loans and exclude these loans from the numerator in calculating our net charge-off, delinquency, nonperforming loan and nonperforming asset rates.

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Table 12: 30+ Day Delinquencies

	June 30, 2011				December 31, 2010			
	30+ Day Performing		30+ Day Total		30+ Day Performing		30+ Day Total	
(Dollars in millions)	Amount	Rate[1]	Amount	Rate[1]	Amount	Rate[1]	Amount	Rate[1]
Credit Card business:								
Domestic credit card and installment loans	**$ 1,798**	**3.33%**	**$ 1,798**	**3.33%**	$ 2,200	4.09%	$ 2,200	4.09%
International credit card and installment loans	**462**	**5.30**	**462**	**5.30**	432	5.75	432	5.75
Total credit card	**2,260**	**3.60**	**2,260**	**3.60**	2,632	4.29	2,632	4.29
Consumer Banking business:								
Automobile	**1,170**	**6.09**	**1,252**	**6.51**	1,355	7.58	1,453	8.13
Home loan[2]	**80**	**0.70**	**487**	**4.30**	77	0.64	504	4.16
Retail banking[2]	**31**	**0.76**	**80**	**1.99**	41	0.93	93	2.11
Total consumer banking[2]	**1,281**	**3.70**	**1,819**	**5.26**	1,473	4.28	2,050	5.96
Commercial Banking business:								
Commercial and multifamily real estate[2]	**65**	**0.47**	**269**	**1.92**	147	1.10	302	2.25
Middle market[2]	**32**	**0.28**	**100**	**0.88**	28	0.27	89	0.85
Specialty lending	**31**	**0.74**	**41**	**1.00**	33	0.81	58	1.44
Small-ticket commercial real estate	**44**	**2.71**	**52**	**3.16**	95	5.16	131	7.11
Total commercial banking[2]	**172**	**0.55**	**462**	**1.48**	303	1.02	580	1.95
Other:								
Other loans	**24**	**5.32**	**68**	**14.59**	22	4.88	69	15.30
Total	**$ 3,737**	**2.90%**	**$ 4,609**	**3.57%**	$ 4,430	3.52%	$ 5,331	4.23%

(1) Delinquency rates are calculated by loan category by dividing 30+ day delinquent loans as of the end of the period by period-end loans held for investment for the specified loan category.

(2) The 30+ day performing delinquency rate, excluding the impact of loans acquired from Chevy Chase Bank from the denominator, for home loans, retail banking, total consumer banking, commercial and multifamily real estate, middle market, and total commercial banking was 1.18%, 0.77%, 4.29%, 0.47%, 0.28% and 0.56%, respectively, as of June 30, 2011, compared with 1.06%, 0.97%, 5.01%, 1.12%, 0.28% and 1.04%, respectively, as of December 31, 2010.

Table 13 presents an aging of total 30+ day delinquent loans included in the above table.

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Table 13: Aging of 30+ Day Delinquent Loans

	June 30, 2011		December 31, 2010	
(Dollars in millions)	Amount	% of Total Loans[1]	Amount	% of Total Loans[1]
Total loan portfolio	**$ 128,965**	**100.00%**	$ 125,947	100.00%
Delinquency status:				
30 59 days	$ 1,748	1.36%	$ 2,008	1.59%
60 89 days	948	0.73	1,103	0.88
90 + days	1,913	1.48	2,220	1.76
Total	$ 4,609	3.57%	$ 5,331	4.23%
Geographic region:				
Domestic	$ 4,147	3.22%	$ 4,899	3.89%
International	462	0.35	432	0.34
Total	$ 4,609	3.57%	$ 5,331	4.23%

(1) Calculated by dividing loans in each delinquency status category and geographic region as of the end of the period by the total loan portfolio.

Table 14 summarizes loans that were 90 days or more past due as to interest or principal payments and still accruing interest as of June 30, 2011 and December 31, 2010. These loans consist primarily of credit card accounts between 90 days and 179 days past due. As permitted by regulatory guidance issued by The Federal Financial Institutions Examination Council (FFIEC), we continue to accrue interest on credit card loans through the date of charge-off, typically in the period the account becomes 180 days past due. While credit card loans remain on accrual status until the loan is charged-off, we establish a reserve for finance charges and fees billed but not expected to be collected and exclude this amount from revenue.

Table 14: 90+ Day Delinquent Loans Accruing Interest

	June 30, 2011		December 31, 2010	
(Dollars in millions)	Amount	% of Total Loans[1]	Amount	% of Total Loans[1]
Loan category:				
Credit card[2]	**$ 1,078**	**1.72%**	$ 1,379	2.25%
Consumer	**3**	**0.01**	5	0.01
Commercial	**11**	**0.04**	14	0.05
Total	**$ 1,092**	**0.85%**	$ 1,398	1.11%
Geographic region[3]:				
Domestic	**$ 880**	**0.68%**	$ 1,195	0.95%
International	**212**	**0.17**	203	0.16
Total	**$ 1,092**	**0.85%**	$ 1,398	1.11%

(1) Delinquency rates are calculated by loan category by dividing 90+ day delinquent loans accruing interest as of the end of the period by period-end loans held for investment for the specified loan category.

(2) Includes credit card loans that continue to accrue finance charges and fees until charged-off at 180 days. The amounts reported for credit card loans are net of billed finance charges and fees that we do not expect to collect. The estimated uncollectible portion of billed finance charges and fees excluded from revenue totaled $112 million and $261 million in the second quarter of 2011 and 2010, respectively, and $217 million and $615 million in the first six months of 2011 and 2010, respectively. The reserve for uncollectible billed finance charges and fees decreased to $153 million as of June 30, 2011, from $211 million as of December 31, 2010.

(3) Calculated by dividing loans in each geographic region as of the end of the period by the total loan portfolio.

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Nonperforming Assets

Nonperforming assets consist of nonperforming loans and foreclosed property and repossessed assets. Nonperforming loans generally include loans that have been placed on nonaccrual status and certain restructured loans whose contractual terms have been restructured in a manner that grants a concession to a borrower experiencing financial difficulty. We continue to classify credit loans as performing until they are charged-off. As a result, delinquent credit cards loans are excluded from the numerator in calculating our nonperforming loan and nonperforming asset rates. We provide an aging of delinquent loans by loan category and describe our policies for classifying loans as nonperforming and for charging-off loans in Note 5 Loans.

Table 15 presents comparative information on nonperforming loans, by loan category, as of June 30, 2011 and December 31, 2010, and the ratio of nonperforming loans to total loans. We do not report loans classified as held for sale as nonperforming, as they are recorded at lower of cost or fair value. We also do not report PCI loans as nonperforming, as these loans were written down to fair value at acquisition and accrete interest income over the remaining life of the loan. We separately track and report the performance of PCI loans. See Purchased Credit-Impaired Loans below for additional information on PCI loans.

Table 15: Nonperforming Loans and Other Nonperforming Assets[1][2]

	June 30, 2011[3]		December 31, 2010	
(Dollars in millions)	Amount	% of Total HFI Loans	Amount	% of Total HFI Loans
Nonperforming loans held for investment:				
Consumer Banking business:				
Automobile	**$ 81**	**0.42%**	$ 99	0.55%
Home loans	**474**	**4.19**	486	4.01
Retail banking	**77**	**1.90**	91	2.07
Total consumer banking	**632**	**1.83**	676	1.97
Commercial Banking business:				
Commercial and multifamily real estate	**307**	**2.18**	276	2.06
Middle market	**129**	**1.13**	133	1.27
Specialty lending	**37**	**0.90**	48	1.20
Total commercial lending	**473**	**1.60**	457	1.64
Small-ticket commercial real estate	**8**	**0.46**	38	2.04
Total commercial banking	**481**	**1.54**	495	1.66
Other:				
Other loans	**51**	**11.02**	54	12.12
Total nonperforming loans held for investment[4]	**$ 1,164**	**0.90%**	$ 1,225	0.97%
Other nonperforming assets:				
Foreclosed property[5]	**$ 207**	**0.16%**	$ 306	0.24%
Repossessed assets	**15**	**0.01**	20	0.02
Total other nonperforming assets	**222**	**0.17**	326	0.26
Total nonperforming assets	**$ 1,386**	**1.07%**	$ 1,551	1.23%

(1) The ratio of nonperforming loans as a percentage of total loans held for investment is calculated based on the nonperforming loans in each loan category divided by the total outstanding unpaid principal balance of loans held for investment in each loan category. The denominator used in calculating the nonperforming asset ratios consists of total loans held for investment and other nonperforming assets.

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(2) The nonperforming loan ratios, excluding the impact of loans acquired from Chevy Chase Bank from the denominator, for home loans, retail banking, total consumer banking, commercial and multifamily real estate, middle market, total commercial banking, and total nonperforming loans held for investment were 7.03%, 1.93%, 2.12%, 2.22%, 1.16%, 1.56% and 0.94%, respectively, as of June 30, 2011, compared with 6.67%, 2.16%, 2.30%, 2.11%, 1.30%, 1.69% and 1.02%, respectively, as of December 31, 2010. The nonperforming asset ratio, excluding loans acquired from Chevy Chase Bank, was 1.12% and 1.29% as of June 30, 2011 and December 31, 2010, respectively.

(3) For the six months ended June 30, 2011, we recognized interest income for loans classified as nonperforming of $11 million. Forgone interest income represents the amount of interest income that would have been recorded during the period for nonperforming loans as of the end of the period had the loans performed according to their contractual terms. For the six months ended June 30, 2011, the interest income forgone related to nonperforming loans as of the end of the period was $30 million.

(4) Nonperforming loans as a percentage of loans held for investment, excluding credit card loans from the denominator, was 1.76% and 1.90% as of June 30, 2011 and December 31, 2010, respectively.

(5) Includes $106 million and $201 million of foreclosed properties related to loans acquired from Chevy Chase Bank, as of June 30, 2011 and December 31, 2010, respectively.

Net Charge-Offs

Net charge-offs consist of the unpaid principal balance of loans held for investment that we determine are uncollectible, net of recovered amounts. We exclude accrued and unpaid finance charges and fees and fraud losses from charge-offs. Charge-offs are recorded as a reduction to the allowance for loan and lease losses and subsequent recoveries of previously charged-off amounts are credited to the allowance for loan and lease losses. Costs incurred to recover charged-off loans are recorded as collection expense and included in our consolidated statements of income as a component of other non-interest expense. We discuss our charge-off time frame for loans, which varies based on the loan type, in Note 5 Loans.

Table 16 presents our net charge-off amounts and rates, by business segment, for the three and six months ended June 30, 2011 and 2010. We provide additional information on the amount of charge-offs by loan category below in Table 18.

Table 16: Net Charge-Offs

	Three Months Ended June 30,				Six Months Ended June 30,			
	2011		2010		2011		2010	
(Dollars in millions)	Amount	Rate[1]	Amount	Rate[1]	Amount	Rate[1]	Amount	Rate[1]
Credit card[2]	**$ 793**	**5.06%**	$ 1,463	9.36%	**$ 1,722**	**5.59%**	$ 3,156	9.84%
Consumer banking[3][4]	**88**	**1.01**	131	1.47	**221**	**1.29**	326	1.76
Commercial banking[3][4]	**38**	**0.50**	90	1.21	**97**	**0.64**	191	1.29
Other	**12**	**10.59**	33	28.51	**36**	**15.23**	62	26.11
Total company[4]	**$ 931**	**2.91%**	$ 1,717	5.36%	**$ 2,076**	**3.28%**	$ 3,735	5.69%
Average loans held for investment[5]	**$ 127,916**		$ 128,203		**$ 126,504**		$ 131,222	

(1) Calculated for each loan category by dividing annualized net charge-offs for the period by average loans held for investment during the period.

(2) The reduction in the provision for loan and lease losses attributable to Kohl s was $212 million in the second quarter and first six months of 2011. Loss sharing amounts attributable to Kohl s reduced charge-offs by $42 million in the second quarter and first six months of 2011. The expected reimbursement from Kohl s netted in our allowance for loan and lease losses was approximately $170 million as of June 30, 2011.

(3) Excludes losses on the purchased credit-impaired loans acquired from Chevy Chase Bank. We separately track and report these loans. We provide additional information on the loans acquired from Chevy Chase Bank in Note 5 Loans.

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(4) The average loans held for investment used in calculating net charge-off rates includes the impact of loans acquired as part of the Chevy Chase Bank acquisition. Our total net charge-off rate, excluding the impact of acquired Chevy Chase Bank loans, was 3.03% and 5.64% for the three months ended June 30, 2011 and 2010, respectively and 3.42% and 6.00% for the six months ended June 30, 2011 and 2010, respectively.

(5) The average balances of the acquired Chevy Chase Bank loan portfolio, which are included in the total average loans held for investment used in calculating the net charge-off rates, were \$5.1 billion and \$6.5 billion for the three months ended June 30, 2011 and 2010, respectively, and \$5.2 billion and \$6.8 billion for the six months ended June 30, 2011 and 2010, respectively.

The overall decrease in net charge-offs in the second quarter and first six months of 2011 from the second quarter and first six months of 2010 reflects the ongoing improvement in credit performance.

Loan Modifications and Restructurings

As part of our customer retention efforts, we may modify loans for certain borrowers who have demonstrated performance under the previous terms. As part of our loss mitigation efforts, we may make loan modifications to a borrower experiencing financial difficulty that are intended to minimize our economic loss and avoid the need for foreclosure or repossession of collateral. We may provide short-term (three to twelve months) or long-term (greater than twelve months) modifications to improve the long-term collectability of the loan. Our most common types of modifications include a reduction in the borrower s initial periodic principal and interest payment through an extension of the loan term, a reduction in the interest rate or a combination of both. These modifications may result in our receiving the full amount due, or certain installments due, under the loan over a period of time that is longer than the period of time originally provided for under the terms of the loan. In some cases, we may curtail the amount of principal owed by the borrower. Loan modifications in which an economic concession has been granted to a borrower experiencing financial difficulty are accounted for and reported as troubled debt restructurings (TDRs).

Table 17 presents the loan balance as of June 30, 2011 and December 31, 2010 of loan modifications made as part of our loss mitigation efforts, all of which are considered to be TDRs. Table 17 excludes loan modifications that do not meet the definition of a TDR and acquired loans from Chevy Chase Bank, which we track and report separately. We provide additional detail on acquired loans from Chevy Chase Bank below under Purchased Credit-Impaired Loan.

Table 17: Loan Modifications and Restructurings(1)

(Dollars in millions)	**June 30, 2011**	**December 31, 2010**(2)
Modified and restructured loans:		
Credit card(3)	**$ 929**	$ 913
Auto(4)	**20**	
Home loans	**71**	57
Retail banking	**23**	13
Commercial	**265**	162
Total	**$ 1,308**	$ 1,145
Status of modified and restructured loans:		
Performing	**$ 1,207**	$ 1,049
Nonperforming	**101**	96
Total	**$ 1,308**	$ 1,145

(1) Reflects modifications and restructuring of loans in our total loan portfolio. The total loan portfolio includes loans recorded on our balance sheet and loans held in securitization trusts.

(2) Certain prior period amounts have been reclassified to conform to the current period presentation.

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(3) Amount reported reflects the total outstanding customer balance, which consists of unpaid principal balance, accrued interest and fees.
(4) Prior to the first quarter of 2011, modified Auto loans were charged-off at the net collateral value and the remaining asset balance was reclassified to Other Assets on our consolidated balance sheet.

The outstanding balance of TDR loan modifications increased to $1.3 billion as of June 30, 2011 from $1.1 billion as of December 31, 2010. Of these modifications, $101 million, or 8%, were classified as nonperforming as of June 30, 2011, compared with $96 million, or 8%, as of December 31, 2010.

Credit card loan modifications have accounted for the substantial majority of our TDR loan modifications, representing $929 million, or 71%, of the outstanding balance of total TDR loans as of June 30, 2011, and $913 million, or 80%, of the outstanding balance of total TDR as of December 31, 2010. The vast majority of our credit card TDR loan modifications involve a reduction in the interest rate on the account and placing the customer on a fixed payment plan not exceeding 60 months. In some cases, the interest rate on a credit card account is automatically increased due to non-payment, late payment or similar events. We determine the effective interest rate for purposes of measuring impairment on modified loans that involve an increase and are considered to be a TDRs based on the interest rate in effect immediately prior to the loan entering the modification program. In all cases, we cancel the customer s available line of credit on the credit card. If the cardholder does not comply with the modified payment terms, then the credit card loan agreement will revert back to its original payment terms, with the amount of any loan outstanding reflected in the appropriate delinquency category. The loan amount may then be charged-off in accordance with our standard charge-off policy.

We typically measure the re-performance rate of modified credit card loans over a 5-year period. Five years after starting a credit card modification, approximately 83% of the balances of modified loans are paid off in full and approximately 17% are charged-off. Based on our experience to date, we believe that credit losses are lower for credit card loans that have been modified than those of similar accounts that were not modified. We therefore plan to expand our short-term credit card loan modification programs and continue our long-term programs.

Home loan modifications represented $71 million, or 5%, of the outstanding balance of total modified loans as of June 30, 2011, compared with $57 million, or 5%, of the outstanding balance of total modified loans as of December 31, 2010. Approximately 78% of our modified mortgage loans include reduction in the contractual interest rate, approximately 23% include a term extension and approximately 22% include a principal reduction. The majority of our modified mortgage loans involve a combination of an interest rate reduction, term extension or principal reduction. Because many of the mortgage loan modification programs have been recently launched and we have had a limited number of modifications under these programs, we do not have sufficient history to fully assess the long-term performance of modified mortgage loans. Of the modified mortgage loans outstanding as of June 30, 2011, approximately 26% were 90 days or more delinquent.

Commercial loan modifications represented $265 million, or 20%, of the outstanding balance of total modified loans as of June 30, 2011, compared with $162 million, or 14%, of the outstanding balance of total modified loans as of December 31, 2010. The vast majority of modified commercial loans include a reduction in interest rate or a term extension. Because we have had only a limited number of commercial loan modifications and the structure of each loan varies, the ultimate success of our commercial loan modifications is uncertain. Of the modified commercial loans outstanding as of June 30, 2011, approximately 10% were 90 days or more delinquent.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due from the borrower in accordance with the original contractual terms of the loan. Loans defined as individually impaired, based on applicable accounting guidance, include larger balance commercial nonperforming loans and TDR loans. We do not report nonperforming consumer loans that have not been modified in a TDR as individually impaired, as we collectively evaluate these smaller-balance homogenous loans for impairment in accordance with applicable accounting guidance. Loans held for sale are also not reported as impaired, as these loans are recorded at lower of cost or fair value. Impaired loans also exclude loans acquired from Chevy Chase Bank because these loans were recorded at fair value upon acquisition.

Impaired loans, including TDRs, totaled $1.6 billion as of June 30, 2011, compared with $1.5 billion as of December 31, 2010. TDRs accounted for $1.3 billion and $1.1 billion of impaired loans as of June 30, 2011 and December 31, 2010, respectively. We provide additional information on our impaired loans, including the allowance established for these loans, in Note 5 Loans and Note 6 Allowance for Loan and Lease Losses.

Purchased Credit-Impaired Loans

Purchased credit-impaired loans decreased to $5.1 billion as of June 30, 2011, from $5.6 billion as of December 31, 2010. Our portfolio of purchased credit-impaired loans consists of loans acquired in the Chevy Chase Bank transaction, which were recorded at fair value at the date of acquisition. The fair value of these loans included an estimate of credit losses expected to be realized over the remaining lives of the loans. Therefore, no allowance for loan and lease losses was recorded for these loans as of the acquisition date. However, we regularly update the amount of expected principal and interest to be collected from these loans and evaluate the results on an aggregated pool basis for loans with common risk characteristics. Probable decreases in expected loan principal cash flows would trigger the recognition of impairment through our provision for loan and lease losses. Probable and significant increases in expected cash flows would first reverse any previously recorded allowance for loan and losses, with any remaining increase in expected cash flows recognized prospectively in interest income over the remaining estimated life of the underlying loans. In the first quarter of 2011, we recorded impairment of $8 million related to certain loan pools. In the second quarter of 2011, we reduced the allowance related to these loans by $28 million as a result of an increase in expected loan principal cash flows. Cumulative impairment recognized on PCI loans totaled $13 million as of June 30, 2011. The credit performance of the remaining pools has generally been in line with our expectations, and, in some cases, more favorable than expected, which has resulted in the reclassification of amounts from the nonaccretable difference to the accretable yield. We provide additional information on the PCI loans acquired from Chevy Chase Bank in Note 5 Loans.

Allowance for Loan and Lease Losses

Our allowance for loan and lease losses represents management s best estimate of incurred loan and lease credit losses inherent in our held-for-investment portfolio as of each balance sheet date. We do not maintain an allowance for held-for-sale loans or purchased credit-impaired loans that are performing in accordance with or better than our expectations as of the date of acquisition, as the fair values of these loans already reflect a credit component. The allowance for loan and lease losses is increased through the provision for loan and lease losses and reduced by net charge-offs. The provision for loan and lease losses, which is charged to earnings, reflects credit losses we believe have been incurred and will eventually be reflected over time in our charge-offs. Charge-offs of uncollectible amounts are deducted from the allowance and subsequent recoveries are added.

Table 18, which displays changes in our allowance for loan and lease losses for the three and six months ended June 30, 2011 and 2010, details, by loan type, the provision for credit losses recognized in our consolidated statements of income each period and the charge-offs recorded against our allowance for loan and lease losses.

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Table 18: Allowance for Loan and Lease Losses Activity

(Dollars in millions)	Three Months Ended June 30, 2011	2010	Six Months Ended June 30, 2011	2010
Balance at beginning of period, as reported	**$ 5,067**	$ 7,752	**$ 5,628**	$ 4,127
Impact from January 1, 2010 adoption of new consolidation accounting	**0**	53	**0**	4,316
Balance at beginning of period, as adjusted	**$ 5,067**	$ 7,805	**$ 5,628**	$ 8,443
Provision for loan and lease losses(1)(2)	**350**	723	**920**	2,201
Charge-offs:				
Credit Card business:(2)				
Domestic credit card and installment loans	**(905)**	(1,607)	**(1,997)**	(3,414)
International credit card and installment loans	**(205)**	(195)	**(398)**	(408)
Total credit card	**(1,110)**	(1,802)	**(2,395)**	(3,822)
Consumer Banking business:				
Auto	**(102)**	(150)	**(243)**	(343)
Home loan	**(22)**	(16)	**(54)**	(53)
Retail banking	**(25)**	(32)	**(55)**	(65)
Total consumer banking	**(149)**	(198)	**(352)**	(461)
Commercial Banking business:				
Commercial and multifamily real estate	**(15)**	(52)	**(39)**	(102)
Middle market	**(9)**	(22)	**(14)**	(45)
Specialty lending	**(6)**	(9)	**(11)**	(18)
Total commercial lending	**(30)**	(83)	**(64)**	(165)
Small-ticket commercial real estate	**(20)**	(23)	**(53)**	(47)
Total commercial banking	**(50)**	(106)	**(117)**	(212)
Other loans	**(13)**	(36)	**(38)**	(66)
Total charge-offs	**(1,322)**	(2,142)	**(2,902)**	(4,561)
Recoveries:				
Credit Card business:				
Domestic credit card and installment loans	**267**	299	**555**	586
International credit card and installment loans	**50**	40	**118**	80
Total credit card	**317**	339	**673**	666
Consumer Banking business:				
Automobile	**50**	60	**102**	120
Home loans	**5**	1	**16**	2
Retail banking	**6**	6	**13**	13
Total consumer banking	**61**	67	**131**	135

Commercial Banking business:				
Commercial and multifamily real estate	**2**	13	**7**	13
Middle market	**5**	1	**6**	4
Specialty lending	**1**	1	**3**	2
Total commercial lending	**8**	15	**16**	19
Small-ticket commercial real estate	**4**	1	**4**	2
Total commercial banking	**12**	16	**20**	21
Other loans	**1**	3	**2**	4
Total recoveries	**391**	425	**826**	826
Net charge-offs	**(931)**	(1,717)	**(2,076)**	(3,735)
Impact from loan sales and other changes	**2**[(3)]	(12)[(4)]	**16**[(3)]	(110)[(4)]
Balance at end of period[(2)]	**$ 4,488**	$ 6,799	**$ 4,488**	$ 6,799

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(1) Excludes negative provision for unfunded lending commitments of $7 million and $4 million for the three months ended June 30, 2011 and 2010, respectively, and $43 million for the six months ended June 30, 2011, and a provision of $17 million for the six months ended June 30, 2010.

(2) The reduction in the provision for loan and lease losses attributable to Kohl s was $212 million in the second quarter and first six months of 2011. Loss sharing amounts attributable to Kohl s reduced charge-offs by $42 million in the second quarter and first six months of 2011. The expected reimbursement from Kohl s netted in our allowance for loan and lease losses was approximately $170 million as of June 30, 2011.

(3) Includes foreign translation adjustment of $2 million and $16 million for the second quarter and first six months of 2011, respectively.

(4) Includes a reduction in our allowance for loan and lease losses of $73 million first quarter of 2010 attributable to the sale of certain interest-only option-ARM bonds and the deconsolidation of the related securitization trusts related to Chevy Chase Bank in the first quarter of 2010.

Table 19 presents an allocation of our allowance for loan and lease losses by loan category as of June 30, 2011 and December 31, 2010:

Table 19: Allocation of the Allowance for Loan and Lease Losses

	June 30, 2011		December 31, 2010	
(Dollars in millions)	**Amount**	**% of Total Loans[1]**	**Amount**	**% of Total Loans[1]**
Credit Card:				
Domestic credit card and installment loans[2]	**$ 2,555**	**4.73%**	$ 3,581	6.65%
International credit card and installment loans	**538**	**6.18**	460	6.12
Total credit card[2]	**3,093**	**4.93**	4,041	6.58
Consumer Banking:				
Auto	**322**	**1.68**	353	1.98
Home loan	**90**	**0.79**	112	0.93
Retail banking	**186**	**4.60**	210	4.76
Total consumer banking	**598**	**1.73**	675	1.96
Commercial Banking:				
Commercial and multifamily real estate	**422**	**3.00**	495	3.70
Middle market	**124**	**1.09**	162	1.55
Specialty lending	**75**	**1.82**	91	2.26
Total commercial lending	**621**	**2.10**	748	2.68
Small-ticket commercial real estate	**109**	**6.64**	78	4.23
Total commercial banking	**730**	**2.34**	826	2.78
Other loans	**67**	**14.41**	86	19.07
Total[2]	**$ 4,488**	**3.48%**	$ 5,628	4.47%
Total allowance coverage ratios:				
Period-end loans	**$ 128,965**	**3.48%**	$ 125,947	4.47%
Nonperforming loans[3]	**1,164**	**385.57**	1,225	459.43
Allowance coverage ratios by loan category:				
Credit card (30 + day delinquent loans)	**$ 2,260**	**136.86%**	$ 2,632	153.53%
Consumer banking (30 + day delinquent loans)	**1,819**	**32.88**	2,050	32.93

Commercial banking (nonperforming loans)	**481**	**151.77**	495	166.87

(1) Calculated based on the allowance for loan and lease losses attributable to each loan category divided by the outstanding balance of loans within the specified loan category.

(2) The reduction in the provision for loan and lease losses attributable to Kohl s was $212 million in the second quarter and first six months of 2011. Loss sharing amounts attributable to Kohl s reduced charge-offs by $42 million in the second quarter and first six months of 2011. The expected reimbursement from Kohl s netted in our allowance for loan and lease losses was approximately $170 million as of June 30, 2011.

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(3) As permitted by regulatory guidance issued by the FFIEC, our policy is generally not to classify credit card loans as nonperforming. We accrue interest on credit card loans through the date of charge-off, typically in the period that the loan becomes 180 days past due. The allowance for loan and lease losses as a percentage of nonperforming loans, excluding the allowance related to our credit card loans, was 119.85% as of June 30, 2011 and 129.55% as of December 31, 2010.

Our allowance for loan and lease losses decreased by $1.1 billion during the first six months of 2011 to $4.5 billion. The decrease in our allowance reflected the continued improvement in credit performance trends across our portfolios as a result of the slowly improving economy coupled with actions we have taken over the past several years to tighten our underwriting standards and exit certain portfolios. Our allowance as a percentage of our total loan portfolio also decreased to 3.48% as of June 30, 2011, from 4.47% as of December 31, 2010.

Deposits

Our deposits have become our largest source of funding for our operations and asset growth. Total deposits increased by $3.9 billion, or 3%, in the first six months of 2011, to $126.1 billion as of June 30, 2011. The increase in deposits was primarily driven by increases of $4.1 billion, $1.8 billion, and $1.3 billion in savings accounts, non-interest bearing deposits, and money market deposits, respectively, which was partially offset by a decrease of $1.9 billion in other consumer time deposits, a $692 million decrease in NOW accounts and a $586 million decrease in certificates of deposit of $100,000 or more, reflecting our shift to more relationship driven, lower cost liquid savings and transaction accounts. We provide additional information on deposits, including the composition of our deposits, average outstanding balances, interest expense and yield, below in Liquidity and Funding.

Senior and Subordinated Notes and Other Borrowings

Senior and subordinated notes and other borrowings increased to $17.9 billion as of June 30, 2011, from $14.9 billion as of December 31, 2010. The increase was primarily attributable to an increase in FHLB advances of $1.9 billion and an increase in federal funds purchased and securities loaned or sold under agreements to repurchase of $1.1 billion. We provide additional information on our borrowings in Note 9 Deposits and Borrowings.

Securitized Debt Obligations

Borrowings owed to securitization investors decreased by $7.1 billion to $19.9 billion as of June 30, 2011, from $26.9 billion as of December 31, 2010. This decrease was attributable to pay downs and charge-offs of the loans underlying the consolidated securitization trusts.

Potential Mortgage Representation & Warranty Liabilities

In recent years, we acquired three subsidiaries that originated residential mortgage loans and sold them to various purchasers, including purchasers who created securitization trusts. These subsidiaries are Capital One Home Loans, which was acquired in February 2005; GreenPoint Mortgage Funding, Inc. (GreenPoint), which was acquired in December 2006 as part of the North Fork acquisition; and Chevy Chase Bank, which was acquired in February 2009 and subsequently merged into CONA.

In connection with their sales of mortgage loans, the subsidiaries entered into agreements containing varying representations and warranties about, among other things, the ownership of the loan, the validity of the lien securing the loan, the loan s compliance with any applicable loan criteria established by the purchaser, including underwriting guidelines and the ongoing existence of mortgage insurance, and the loan s compliance with applicable federal, state and local laws. The representations and warranties do not address the credit performance of the mortgage loans, but mortgage loan performance often influences whether a claim for breach of representation and warranty will be asserted and has an effect on the amount of any loss in the event of a breach of a representation or warranty.

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Each of these subsidiaries may be required to repurchase mortgage loans in the event of certain breaches of these representations and warranties. In the event of a repurchase, the subsidiary is typically required to pay the then unpaid principal balance of the loan together with interest and certain expenses (including, in certain cases, legal costs incurred by the purchaser and/or others). The subsidiary then recovers the loan or, if the loan has been foreclosed, the underlying collateral. The subsidiary is exposed to any losses on the repurchased loans after giving effect to any recoveries on the collateral. In some instances, rather than repurchase the loans, a subsidiary may agree to make a cash payment to make an investor whole on losses or to settle repurchase claims. In addition, our subsidiaries may be required to indemnify certain purchasers and others against losses they incur as a result of certain breaches of representations and warranties. In some cases, the amount of such losses could exceed the repurchase amount of the related loans.

These subsidiaries, in total, originated and sold to non-affiliates approximately $111 billion original principal balance of mortgage loans between 2005 and 2008, which are the years (or vintages) with respect to which our subsidiaries have received the vast majority of the repurchase requests and other related claims.

Table 20 presents the original principal balance of mortgage loan originations, by vintage, for the three general categories of purchasers of mortgage loans and the outstanding principal balance as of June 30, 2011 and December 31, 2010:

Table 20: Unpaid Principal Balance of Mortgage Loans Originated and Sold to Third Parties Based on Category of Purchaser

	Unpaid Principal Balance		Original Unpaid Principal Balance				
(Dollars in billions)	**June 30, 2011**	**December 31, 2010**	**Total**	**2008**	**2007**	**2006**	**2005**
Government sponsored enterprises (GSEs[1])	$ 5	$ 5	$ 11	$ 1	$ 4	$ 3	$ 3
Insured Securitizations	7	7	18		1	8	9
Uninsured Securitizations and Other	29	33	82	3	16	30	33
Total	$ 41	$ 45	$ 111	$ 4	$ 21	$ 41	$ 45

(1) GSEs include Fannie Mae and Freddie Mac.

Between 2005 and 2008, our subsidiaries sold an aggregate amount of $11 billion in original principal balance mortgage loans to the GSEs.

Of the $18 billion in original principal balance of mortgage loans sold directly by our subsidiaries to private-label purchasers who placed the loans into securitizations supported by bond insurance (Insured Securitizations), approximately $13 billion original principal balance was placed in securitizations as to which the monoline bond insurers have made repurchase requests or loan file requests to one of our subsidiaries (Active Insured Securitizations), and the remaining approximately $5 billion original principal balance was placed in securitizations as to which the monoline bond insurers have not made repurchase requests or loan file requests to one of our subsidiaries (Inactive Insured Securitizations). Insured Securitizations often allow the monoline bond insurer to act independently of the investors. Bond insurers typically have indemnity agreements directly with both the mortgage originators and the securitizers, and they often have super-majority rights within the trust documentation that allow them to direct trustees to pursue mortgage repurchase requests without coordination with other investors.

Because we do not service most of the loans our subsidiaries sold to others, we do not have complete information about the current ownership of the $82 billion in original principal balance of mortgage loans not sold directly to GSEs or placed in Insured Securitizations. We have determined from third-party databases that about $39 billion original principal balance of these mortgage loans are currently held by private-label publicly issued

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securitizations not supported by bond insurance (Uninsured Securitizations). In contrast with the bond insurers in Insured Securitizations, investors in Uninsured Securitizations often face a number of legal and logistical hurdles before they can direct a securitization trustee to pursue mortgage repurchases, including the need to coordinate with a certain percentage of investors holding the securities and to indemnify the trustee for any litigation it undertakes. An additional approximately $30 billion original principal balance of mortgage loans were initially sold to private investors as whole loans. Of this amount, we believe approximately $10 billion original principal balance of mortgage loans were ultimately purchased by GSEs. For purposes of our reserves-setting process, we consider these loans to be private-label loans rather than GSE loans. We do not have information about the current holders or disposition of the remaining $13 billion original principal balance of mortgage loans in this category.

With respect to the $111 billion in original principal balance of mortgage loans originated and sold to others between 2005 and 2008, we estimate that approximately $41 billion in unpaid principal balance remains outstanding as of June 30, 2011, approximately $14 billion in losses have been realized and approximately $13 billion in unpaid principal balance is at least 90 days delinquent. Because we do not service most of the loans we sold to others, we do not have complete information about the underlying credit performance levels for some of these mortgage loans. These amounts reflect our best estimates, including extrapolations where necessary. These extrapolations occur on the approximately $13 billion original principal balance of mortgage loans for which we do not have information about the current holders or any underlying credit performance. These estimates could change as we get additional data or refine our analysis.

The subsidiaries had open repurchase requests relating to approximately $1.7 billion original principal balance of mortgage loans as of June 30, 2011, compared with $1.6 billion as of December 31, 2010. As of June 30, 2011, the vast majority of new repurchase demands received over the last year and, as discussed below, almost all of our $869 million reserve relates to the $24 billion of original principal balance of mortgage loans originally sold to the GSEs or to Active Insured Securitizations. Currently, repurchase demands predominantly relate to the 2006 and 2007 vintages. We have received relatively few repurchase demands from the 2008 and 2009 vintages, mostly because GreenPoint ceased originating mortgages in August 2007.

Table 21 presents information on pending repurchase requests by counterparty category and timing of initial repurchase request. The amounts presented are based on original loan principal balances.

Table 21: Open Pipeline All Vintages (all entities)[1]

(Dollars in millions)	GSEs	Insured Securitizations	Uninsured Securitizations and Other	Total
Open claims as of December 31, 2009	$ 61	$ 366	$ 588	$ 1,015
Gross new demands received	204	645	104	953
Loans repurchased/made whole[2]	(52)	(179)	(5)	(236)
Demands rescinded[2]	(87)		(22)	(109)
Open claims as of December 31, 2010	**$ 126**	**$ 832**	**$ 665**	**$ 1,623**
Gross new demands received	**88**	**96**	**43**	**227**
Loans repurchased/made whole	**(40)**	**0**	**(8)**	**(48)**
Demands rescinded	**(47)**	**0**	**(9)**	**(56)**
Reclassifications[3]	**(5)**	**64**	**(59)**	
Open claims as of June 30, 2011	**$ 122**	**$ 992**	**$ 632**	**$ 1,746**

(1) The open pipeline includes all repurchase requests ever received by our subsidiaries where the requesting party has not formally rescinded the repurchase request and where our subsidiary has not agreed to either repurchase the loan at issue or make the requesting party whole with respect to its losses. Accordingly, repurchase requests denied by our subsidiaries and not pursued by the counterparty remain in the open pipeline. Moreover, repurchase requests submitted

by parties without contractual standing to pursue repurchase requests are included within the open pipeline unless the requesting party has formally rescinded its repurchase request. Finally, the amounts reflected in this chart are original principal balance amounts and do not correspond to the losses our subsidiary would incur upon the repurchase of these loans.

(2) Activity in 2010 relates to repurchase demands from all years prior.

(3) Represents adjustments to correct the counterparty category as of December 31, 2010 for amounts that were misclassified. The reclassification had no impact on the total pending repurchase requests; however, it resulted in an increase in open claims attributable to insured securitizations and a decrease in open claims attributable to GSEs and Uninsured Securitizations & Other.

We have established representation and warranty reserves for losses associated with the mortgage loans sold by each subsidiary that we consider to be both probable and reasonably estimable, including both litigation and non-litigation liabilities. These reserves are reported in our consolidated balance sheets as a component of other liabilities. The reserve setting process relies heavily on estimates, which are inherently uncertain, and requires the application of judgment. We evaluate these estimates on a quarterly basis. We build our representation and warranty reserves through the provision for repurchase losses, which we report in our consolidated statements of income as a component of non-interest income for loans originated and sold by Chevy Chase Bank and Capital One Home Loans and as a component of discontinued operations for loans originated and sold by GreenPoint. In establishing the representation and warranty reserves, we consider a variety of factors depending on the category of purchaser.

In establishing reserves for the $11 billion original principal balance of GSE loans, we rely on the historical relationship between GSE loan losses and repurchase outcomes to estimate: (1) the percentage of current and future GSE loan defaults that we anticipate will result in repurchase requests from the GSEs over the lifetime of the GSE loans; and (2) the percentage of those repurchase requests that we anticipate will result in actual repurchases. We also rely on estimated collateral valuations and loss forecast models to estimate our lifetime liability on GSE loans. This reserving approach to the GSE loans reflects the historical interaction with the GSEs around repurchase requests, and also includes anticipated repurchases resulting from mortgage insurance rescissions. The GSEs typically have stronger contractual rights than non-GSE counterparties because GSE contracts typically do not contain prompt notice requirements for repurchase requests or materiality qualifications to the representations and warranties. Moreover, although we often disagree with the GSEs about the validity of their repurchase requests, we have established a negotiation pattern whereby the GSEs and our subsidiaries continually negotiate around individual repurchase requests, leading to the GSEs rescinding some repurchase requests and our subsidiaries agreeing in some cases to repurchase some loans or make the GSEs whole with respect to losses. Our lifetime representation and warranty reserves with respect to GSE loans are grounded in this history.

For the $13 billion original principal balance in Active Insured Securitizations, our reserving approach also reflects our historical interaction with monoline bond insurers around repurchase requests. Typically, monoline bond insurers allege a very high repurchase rate with respect to the mortgage loans in the Active Insured Securitization category. In response to these repurchase requests, our subsidiaries typically request information from the monoline bond insurers demonstrating that the contractual requirements around a valid repurchase request have been satisfied, such as, for example, the typical requirements that the counterparty promptly notify us upon discovery of any breach and that any breach materially and adversely affect the value of the mortgage loan at issue. In response to these requests for supporting documentation, monoline bond insurers typically initiate litigation. Accordingly, our reserves within the Active Insured Securitization are not based upon the historical repurchase rate with monoline bond insurers, but rather upon the expected resolution of litigation with the monoline bond insurers. Every bond insurer within this category is pursuing a substantially similar litigation strategy either through active or probable litigation. Accordingly, our representation and warranty reserves for this category are litigation reserves. In establishing litigation reserves for this category, we consider current and future losses inherent within the securitization and apply legal judgment to the anticipated factual and legal record to estimate the lifetime legal liability for each securitization. Our estimated legal liability for each securitization within this category assumes that we will be responsible for only a portion of the losses inherent in each securitization. Our litigation reserves with respect to both the U.S. Bank Lawsuit and the DBSP Lawsuit, in each case as referenced below, are contained within the Active Insured Securitization reserve category. Further, our litigation reserves with respect to indemnification risks from certain representation and warranty lawsuits brought by monoline bond insurers against third-party securitizations sponsors, where GreenPoint provided some or all of the mortgage collateral within the securitization but is not a defendant in the litigation, are also contained within this category. Our estimated legal liability for each securitization within this category assumes we will pay only a portion of the liabilities ultimately incurred by the party defendants to the litigation.

For the $5 billion original principal balance of mortgage loans in the Inactive Insured Securitizations category and the $82 billion original principal balance of mortgage loans in the Uninsured Securitizations and other whole loan sales categories, we establish reserves by relying on our historical repurchase rates and current negotiation patterns to estimate repurchase liabilities over the next twelve (12) months. We do not believe we can estimate repurchase liability for these categories for a period longer than twelve (12) months because of the relatively irregular nature of repurchase activity within these categories. Some Uninsured Securitization investors from this category who have not made repurchase requests or filed representation and warranty lawsuits have filed actions under federal and/or state securities laws against investment banks and securitization sponsors. Although we face some direct and indirect indemnity risks from these litigations, we have not established reserves with respect to these indemnity risks because we do not consider them to be both probable and reasonably estimable liabilities.

The aggregate reserve for all three subsidiaries was $869 million as of June 30, 2011, compared with $846 million as of March 31, 2011, and with $816 million as of December 31, 2010. Almost all of the increase in the reserve from March 31, 2011 is allocated to the Uninsured Securitizations and Other category, as reflected in Table 23, resulting from an increase in repurchase activity with respect to certain whole loan investors. We recorded a total provision for repurchase losses for our representation and warranty repurchase exposure of $37 million and $81 million for the three and six months ended June 30, 2011, respectively, and we had settlements of repurchase requests of $14 million and $28 million for the three and six months ended June 30, 2011, respectively, that were charged against the reserve.

Table 22 summarizes changes in our representation and warranty reserve for the three and six months ended June 30, 2011 and 2010, and for full year 2010.

Table 22: Changes in Representation and Warranty Reserve

(Dollars in millions)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010	Full Year 2010
Representation and warranty repurchase reserve, beginning of period[1]	**$ 846**	$ 454	**$ 816**	$ 238	$ 238
Provision for repurchase losses[2]	**37**	404	**81**	628	636
Net realized losses	**(14)**	(5)	**(28)**	(13)	(58)
Representation and warranty repurchase reserve, end of period[1]	**$ 869**	$ 853	**$ 869**	$ 853	$ 816

(1) Reported in our consolidated balance sheets as a component of other liabilities.

(2) The portion of the provision for mortgage repurchase claims recognized in our consolidated statements of income as a component of non-interest income totaled $4 million and $9 million for the three and six months ended June 30, 2011, respectively, and $95 million and $195 million for the three and six months ended June 30, 2010, respectively. The pre-tax portion of the provision for mortgage repurchase claims recognized in our consolidated statements of income as a component of discontinued operations totaled $33 million and $72 million, for the three and six months ended June 30, 2011, respectively, and $309 million and $433 million for the three and six months ended June 30, 2010, respectively.

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As indicated in Table 23 below, substantially all of the representation and warranty reserve relates to the $11 billion in original principal balance of mortgage loans sold directly to the GSEs and to the $13 billion in mortgage loans sold to purchasers who placed them into Active Insured Securitizations.

Table 23: Allocation of Representation and Warranty Reserve

(Dollars in millions, except for loans sold)	Reserve Liability June 30, 2011	Reserve Liability December 31, 2010	Loans Sold 2005 to 2008[1]
GSEs and Active Insured Securitizations	**$ 794**	$ 796	$ 24
Inactive Insured Securitizations, Uninsured Securitizations and Other	**75**	20	87
Total	**$ 869**	$ 816	$ 111

(1) Reflects, in billions, the total original principal balance of mortgage loans originated by our subsidiaries and sold to third party investors between 2005 and 2008.

The adequacy of the reserves and the ultimate amount of losses incurred by our subsidiaries will depend on, among other things, actual future mortgage loan performance, the actual level of future repurchase and indemnification requests (including the extent, if any, to which Inactive Insured Securitizations and other currently inactive investors ultimately assert claims), the actual success rates of claimants, developments in litigation, actual recoveries on the collateral and macroeconomic conditions (including unemployment levels and housing prices).

As part of our business planning processes, we have considered various outcomes relating to the potential future representation and warranty liabilities of our subsidiaries that are possible but do not rise to the level of being both probable and reasonably estimable outcomes that would justify an incremental accrual under applicable accounting standards. We believe that the upper end of the reasonably possible future losses from representation and warranty claims beyond the current accrual levels, including reasonably possible future losses relating to the US Bank Litigation and DBSP Litigation, could be as high as $1.1 billion. Notwithstanding our attempt to estimate a reasonably possible amount of loss beyond our current accrual levels based on current information, it is possible that actual future losses will exceed both the current accrual level and the amount of reasonably possible losses estimated here. There is still significant uncertainty as to numerous factors that contribute to ultimate liability levels, including, but not limited to, litigation outcomes, future repurchase claims levels, ultimate repurchase success rates and mortgage loan performance levels.

Also see representation and warranty liabilities and litigation claims in Note 15 Commitments, Contingencies and Guarantees.

OFF-BALANCE SHEET ARRANGEMENTS AND VARIABLE INTEREST ENTITIES

In the ordinary course of business, we are involved in various types of arrangements with limited liability companies, partnerships or trusts that often involve special purpose entities and variable interest entities (VIEs). Some of these arrangements are not recorded on our consolidated balance sheets or may be recorded in amounts different from the full contract or notional amount of the arrangements, depending on the nature or structure of, and accounting required to be applied to, the arrangement. These arrangements may expose us to potential losses in excess of the amounts recorded in the consolidated balance sheets. Our involvement in these arrangements can take many forms, including securitization and servicing activities, the purchase or sale of mortgage-backed or other asset-backed securities in connection with our home loan portfolio and loans to VIEs that hold debt, equity, real estate or other assets. Under previous accounting guidance, we were not required to consolidate the majority of our securitization trusts because they were qualified special purpose entities. Accordingly, we considered these trusts to be off-balance sheet arrangements.

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Our continuing involvement in unconsolidated VIEs primarily consists of certain mortgage loan trusts and community reinvestment and development entities. The carrying amount of assets and liabilities of these unconsolidated VIEs was $2.0 billion and $236 million, respectively, as of June 30, 2011, and our maximum exposure to loss was $2.0 billion. We provide a discussion of our activities related to these VIEs in Note 7 Variable Interest Entities and Securitizations.

RISK MANAGEMENT

Our business activities expose us to eight major categories of risks: liquidity risk, credit risk, reputational risk, market risk, strategic risk, operational risk, compliance risk and legal risk. Our risk management framework is intended to identify, assess and mitigate risks that affect or have the potential to affect our business in order to target financial returns commensurate with our risk appetite and to avoid excessive risk-taking. We follow four key risk management principles:

Individual businesses take and manage risk in pursuit of strategic, financial and other business objectives.

Independent risk management organizations support individual businesses by providing risk management tools and policies and by aggregating risks; in some cases, risks are managed centrally.

The Board of Directors and senior management review our aggregate risk position, establish the risk appetite and work with management to ensure conformance to policy and adherence to our adopted mitigation strategy.

We employ a top risk identification system to maintain the appropriate focus on the risks and issues that may have the most impact and to identify emerging risks of consequence.

LIQUIDITY AND CAPITAL MANAGEMENT

Liquidity

We have established liquidity guidelines that are intended to ensure that we have sufficient asset-based liquidity to withstand the potential impact of deposit attrition or diminished liquidity in the funding markets. Our guidelines include maintaining an adequate liquidity reserve to cover our potential funding requirements and diversified funding sources to avoid over-dependence on volatile, less reliable funding markets. Our liquidity reserves consist of cash and cash equivalents, unencumbered available-for-sale securities and undrawn committed securitization borrowing facilities. Table 24 below presents the composition of our liquidity reserves as of June 30, 2011 and December 31, 2010.

Table 24: Liquidity Reserves

(Dollars in millions)	June 30, 2011