Discover Financial Services
Form 10-K
January 26, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended November 30, 2010

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

For the transition period from to

Commission File Number 001-33378

DISCOVER FINANCIAL SERVICES

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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 ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

The aggregate market value of the common equity held by non-affiliates of the registrant on the last business day of the registrant s most recently completed second fiscal quarter was approximately $7,288,905,307.

As of January 15, 2011, there were 545,246,937 shares of the registrant s Common Stock, par value $0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its annual stockholders meeting to be held on April 7, 2011 are incorporated by reference in Part III of this Form 10-K.

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DISCOVER FINANCIAL SERVICES

Annual Report on Form 10-K for the year ended November 30, 2010

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Except as otherwise indicated or unless the context otherwise requires, Discover Financial Services, Discover, DFS, we, us, our, and the Company refer to Discover Financial Services and its subsidiaries.

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

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Part I. | Item 1. Business

Introduction

Discover Financial Services is a direct banking and payment services company. We are a bank holding company under the Bank Holding Company Act of 1956, subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve). We are also a financial holding company under the Gramm-Leach-Bliley Act.

We offer credit cards, student loans, personal loans and deposit products through our Discover Bank subsidiary. Although we have historically offered both federal and private student loans, in 2010 we decided to sell all our remaining federal student loans. We had $48.8 billion in loan receivables and $20.6 billion in deposits issued through direct-to-consumer channels and affinity relationships at November 30, 2010. We operate the Discover Network, our credit card payments network; the PULSE network (PULSE), our automated teller machine (ATM), debit and electronic funds transfer network; and Diners Club International (Diners Club), our global payments network.

Acquisition of The Student Loan Corporation

We recently expanded our private student loan business as part of our direct banking strategy. On December 31, 2010, we acquired The Student Loan Corporation (SLC) in a merger transaction for $600 million. We received a purchase price closing adjustment in the form of a cash payment of approximately $234 million from Citibank, N.A. (Citibank), the 80% owner of SLC before the merger, resulting in a net cash outlay of approximately $366 million for the acquisition of SLC. In the transaction, we acquired SLC s ongoing private student loan business and approximately $4.2 billion of private student loans and other assets, along with assuming approximately $3.4 billion of SLC s existing asset-backed securitization debt funding and other liabilities. We acquired the loans and other assets at an 8.5% discount, which will be applied to balance sheet items through purchase accounting entries. SLC is now a wholly-owned subsidiary of Discover Bank. The acquisition significantly increased the size of our private student loan portfolio, which was $1.0 billion at November 30, 2010. In addition, the acquisition has provided us with a developed student loan business platform, additional school relationships, experienced personnel and SLC s website.

Available Information

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

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

Operating Model

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

We are principally engaged in providing products and services to customers in the United States, although the royalty revenue we receive from Diners Club licensees is derived from sources outside of the United States. For quantitative information concerning our geographic distribution, see Note 6: Loan Receivables to our consolidated financial statements and for quantitative information concerning our royalty revenue, see Note 16: Other Income and Other Expense.

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Below are descriptions of the principal products and services of each of our reportable segments. For additional financial information relating to our business and our operating segments, see Note 24: Segment Disclosures to our consolidated financial statements.

Direct Banking

Credit Cards

We offer credit cards to consumers and small businesses. Our credit card customers are permitted to revolve their balances and repay their obligations over a period of time and at an interest rate set forth in their cardmember agreements, which may be either fixed or variable. The interest that we earn on revolving credit card balances makes up 95% of our total interest income. We also charge customers other fees, including fees for late payments, balance transfer transactions, cash advance transactions and foreign currency transactions. We also offer various products and services in connection with our credit card business, such as Payment Protection, Identity Theft Protection, Wallet Protection, Credit ScoreTracker and other fee-based products.

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

Where we do not have a direct relationship with a merchant, we receive acquirer interchange and assessment fees from the merchant acquirer that settles transactions with the merchant. The amount of this fee is based on a standardized schedule and can vary based on the type of merchant or type of card (e.g., consumer or business). Most of our cards offer the *Cashback Bonus* rewards program, the costs of which we record as a reduction of discount and interchange revenue.

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

Student Loans

Our student loans help students and parents finance education costs at select schools with undergraduate, graduate and post-graduate degree programs. Private student loans are intended to supplement any financial aid that may be available through grants, scholarships or under the federal government s Direct Lending Program. Historically, we have offered both federal and private student loans. However, effective July 2010, federal legislation required all federal student loans to be made directly by the federal government and as of November 30, 2010, our remaining federal student loan portfolio was classified as held for sale.

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In 2011, we will offer Discover Student Loans through Discover Bank, and during a transition period, CitiAssist® Loans which are originated by Citibank, N.A. (Citibank) and subsequently purchased by Discover Bank. Our private student loans are marketed through colleges and universities, including schools where Discover or Citibank is named a preferred lender. Discover Student Loans and CitiAssist Loans are also marketed online and through direct mail. In addition, CitiAssist loans are marketed through marketing agreements with Citibank and its affiliates.

Customers can apply for a Discover Student Loan by mail, online or by phone, where we have dedicated staff within our Discover call centers to service student loans. Customers can apply for a CitiAssist Loan online. As part of the loan approval process, both Discover Student Loans and CitiAssist Loans are certified with the school to confirm enrollment so that loan funds are applied to educational expenses. To ensure proper use of loan funds, the majority of loan disbursements are made directly to schools. Upon graduation, Discover Student Loan borrowers are generally eligible to receive a Graduation Reward on the date of their graduation. Students may redeem their Graduation Reward as a credit to the balance of their student loan or as a direct deposit to a bank account.

Personal Loans

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

Deposit Products

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

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

Payment Services

PULSE network

Our PULSE network is one of the nation s leading ATM/debit networks. PULSE links cardholders of more than 4,400 financial institutions with ATMs and point-of-sale (POS) terminals located throughout the United States. PULSE also provides cash access at over 750,000 ATMs in over 80 countries. PULSE s primary source of revenue is transaction fees charged for switching and settling ATM, personal identification number (PIN) POS debit and signature debit transactions initiated through the use of debit cards issued by participating financial institutions. In addition, PULSE offers a variety of optional products and services that produce income for the network, including signature debit processing, prepaid card processing, and connections to other regional and national electronic funds transfer networks.

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

Diners Club

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

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

Third-Party Issuing Business

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

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

The discussion below provides additional detail concerning the supporting functions of our two segments. The credit card, student loan, personal loan and deposit products issued through our Direct Banking segment require significant investments in credit risk management, marketing, customer service and technology, whereas the operation of the Discover Network and our Payment Services business requires that we invest in technology as well as relationships with issuers, merchants and merchant acquirers.

Credit Risk Management

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

Account Acquisition (New Customers)

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

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

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

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

Credit Card Portfolio Management (Existing Customers)

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

Customer Assistance

We provide our customers with a variety of tools to proactively manage their accounts, including a website dedicated to customer education and payment reminders through email and mobile text alerts. These tools are designed to limit a customer s risk of becoming delinquent. However, once a customer s account becomes delinquent or is at risk of becoming delinquent, we employ a variety of strategies to assist customers in becoming current on their accounts.

All monthly billing statements of accounts with past due amounts include a request for payment of such amounts. After the first monthly statement that reflects a past due amount, these accounts also receive a written notice of late fee charges as well as an additional request for payment. Customer assistance personnel generally initiate contact with customers within 30 days after any portion of their balance becomes past due. The nature and the timing of the initial contact, typically a personal call or letter, are determined by a review of the customer s prior account activity and payment habits.

We reevaluate our collection efforts and consider the implementation of other techniques, including internal collection activities and use of external vendors, as a customer becomes increasingly delinquent. We limit our exposure to

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delinquencies through controls within the authorizations system and criteria based account suspension and revocation. In situations involving customers with financial difficulties, we may enter into arrangements to extend or otherwise change payment schedules, lower their interest rates and/or waive fees to aid customers in becoming current on their obligations to us.

Marketing

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

Product Development

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

Rewards/Cashback Bonus

Under our *Cashback Bonus* program, we provide our credit card customers with up to 1% *Cashback Bonus*, based upon their spending level and type of purchases. Customers earn 0.25% on their first $3,000 in annual purchases and 1% once their total annual purchases exceed $3,000. Purchases made at warehouse clubs and discount stores earn a fixed *Cashback Bonus* of 0.25%.

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

- *Discover More* card offers 5% *Cashback Bonus* on purchases up to a specified amount, subject to certain limitations, in large retail categories such as gasoline, grocery, restaurants, travel, department stores and home improvement stores, that change throughout the year, and up to 1% unlimited *Cashback Bonus* on all other purchases.

- *Discover Motiva card* provides customers with *Cashback Bonus* as a reward for making on-time payments and up to 1% unlimited *Cashback Bonus* on all other purchases.

- *Miles by Discover* customers receive two miles for every $1 on the first $3,000 in travel and restaurant purchases each year and one mile for every $1 on all other purchases.

- *Escape by Discover* customers earn two miles for every $1 on all purchases that can be redeemed for travel credits, gift cards, cash or merchandise. This card has a $60 annual fee.

- *Discover Open Road card* customers can earn 2% *Cashback Bonus* on the first $250 in gas and restaurant purchases each billing period and up to 1% *Cashback Bonus* on all other purchases.

- *Discover Business card* offers 5% *Cashback Bonus* on the first $2,000 in office supply purchases, 2% *Cashback Bonus* on the first $2,000 in gas purchases and up to 1% unlimited *Cashback Bonus* on all other purchases each year.

Customers who are not delinquent or otherwise disqualified may redeem their *Cashback Bonus* starting at $20 for partner gift cards that turn their *Cashback Bonus* into bigger rewards, brand-name merchandise with free shipping, Discover gift cards or a charitable donation to select charities. For customers who prefer cash, *Cashback Bonus* can be redeemed starting at $50 in the form of a statement credit or direct deposit to a bank account in increments of $50.

Miles can be redeemed for travel credits starting at 10,000 miles, merchandise starting at 4,000 miles, partner gift cards starting at 1,000 miles, Discover gift cards starting at 5,000 miles, cash in the form of statement credits or direct deposit to a bank account starting at 5,000 miles or charitable donations starting at 5,000 miles.

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Fee Products

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

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

Payment Protection. This service allows customers to suspend their payments for up to two years, depending on the product, in the event of certain covered events. Different products cover different events, such as unemployment, disability or other life events. Depending on the product and availability under state laws, outstanding balances up to certain amounts are cancelled in the event of death.

Wallet Protection. This service offers one-call convenience if the customer s wallet is lost or stolen, including requesting cancellation and replacement of the customer s credit and debit cards, monitoring the customer s credit bureau reports for 90 days, providing up to $100 to replace the customer s wallet and, if needed, lending the customer up to $1,000 in emergency cash.

Credit ScoreTracker. This product offers customers resources that help them understand and monitor their credit score. Credit ScoreTracker is specifically designed for score monitoring by alerting customers when their score changes, allowing customers to set a target score and providing resources to help them understand the factors that may be influencing their score.

Extended Warranties. Discover customers can purchase online service warranties from Square Trade, our extended warranty provider, to protect their purchases of new electronics and appliances from any retailer as well as certain other purchases.

Brand and Advertising Management

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

Customer Service

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

Online account services that allow customers to customize their accounts, choose how and when they pay their bills, create annual account summaries that assist them with budgeting and taxes, research transaction details, initiate transaction disputes, and chat with or email a customer representative;

Email and mobile text reminders to help customers avoid fees and track big purchases or returns;

Money management tools like the Spend Analyzer, Paydown Planner and Purchase Planner;

Secure online account numbers that let customers shop online without ever revealing their actual account numbers; and

ShopDiscover, an online portal where customers automatically earn 5 20% *Cashback Bonus* when they shop at well-known online merchants using their Discover card.

Processing Services

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

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Fraud Prevention

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

Each credit card transaction is subject to screening, authorization and approval through a proprietary POS decision system. We use a variety of techniques that help identify and halt fraudulent transactions, including adaptive models, rules-based decision-making logic, report analysis, data integrity checks and manual account reviews. Accounts identified by the fraud detection system are managed by proprietary software that integrates fraud prevention and customer service. Strategies are subject to regular review and enhancement to enable us to respond quickly to changing credit conditions as well as to protect our customers and our business from emerging fraud activity.

Discover Card Terms and Conditions

The terms and conditions governing our credit card products vary by product and change over time. Each credit card customer enters into a cardmember agreement governing the terms and conditions of the customer s account. Discover card s terms and conditions are generally uniform from state to state. The cardmember agreement permits us, to the extent permitted by law, to change any term of the cardmember agreement, including any finance charge, rate or fee, or add or delete any term of the cardmember agreement, with notice to the customer as required by law. The customer has the right to opt out of certain changes of terms and pay their balance off under the unchanged terms. Each cardmember agreement provides that the account can be used for purchases, cash advances and balance transfers. Each Discover card account is assigned a credit limit when the account is initially opened. Thereafter, individual credit limits may be increased or decreased from time to time, at our discretion, based primarily on our evaluation of the customer s creditworthiness. We offer various features and services with the Discover card accounts, including the *Cashback Bonus* reward described under Marketing Rewards/*Cashback Bonus*.

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

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

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

In addition to periodic finance charges, we may impose other charges and fees on Discover card accounts, including cash advance transaction fees, late fees where a customer has not made a minimum payment by the required due date,

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balance transfer fees, foreign currency transaction fees and returned payment fees. We also charge fees for each time we decline to honor a balance transfer check, cash advance check, or other promotional check due to such reasons as insufficient credit availability, delinquency or default.

The Credit Card Accountability Responsibility and Disclosure Act of 2009 requires us, beginning February 2011, to periodically review annual percentage rates that were increased on accounts since January 1, 2009.

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

Discover Network Operations

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

We maintain direct relationships with most of our largest merchant accounts which enables us to capitalize on joint marketing programs and opportunities and to retain the entire discount revenue from the merchant. The terms of our direct merchant relationships are governed by a merchant services agreement. These agreements also are accompanied by additional program documents that further define our network functionality and requirements, including operating regulations, technical specifications and dispute rules. To enable ongoing improvements in our network s functionality and in accordance with industry convention, we publish updates to our program documents on a semi-annual basis. Discover card transaction volume was concentrated among our top 100 merchants in 2010, with our largest merchant accounting for approximately 8% of that transaction volume.

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

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

Technology

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

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

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Seasonality

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

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

Competition

We compete with other credit card issuers and networks on the basis of a number of factors, including brand, reputation, reward programs, customer service, merchant acceptance, product offerings, incentives, and pricing. As a credit card issuer, we compete for accounts and utilization with cards issued by other financial institutions (including American Express, Bank of America, Capital One, JPMorgan Chase and Citigroup) and, to a lesser extent, businesses that issue their own private label cards or otherwise extend credit to their customers. In comparison to our largest credit card competitors, our strengths have included cash rewards, conservative portfolio management and strong customer service. As a student loan issuer, we compete for customers with Sallie Mae, Wells Fargo and JPMorgan Chase, as well as other financial institutions that offer student loans, on the basis of customer service, pricing and rewards. As a personal loan issuer, we compete for customers primarily with Bank of America, JPMorgan Chase, Capital One and Wells Fargo, generally on the basis of the loan product s terms.

Although our student and personal loan receivables have increased as a percentage of total loans, our credit card receivables continue to represent a substantial portion of our receivables. The credit card business is highly competitive. Some of our competitors offer a wider variety of loan products than we do, including automobile and home loans, which may position them better among customers who prefer to use a single financial institution to meet all of their financial needs. Some of our competitors enjoy lower cost of funds and greater capital resources than we do, and are therefore able to invest more in initiatives to attract and retain customers, such as advertising, targeted marketing, account acquisitions and pricing competition in interest rates, annual fees, reward programs and low-priced balance transfer programs.

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

In our payment services business, we compete with other networks for volume and to attract third-party issuers to issue credit, debit and prepaid cards on the Discover, PULSE and Diners Club networks. We generally compete on the basis of customization of services and various pricing strategies, including incentives and rebates. The Diners Club and Discover networks primary competitors are Visa, MasterCard and American Express, and PULSE s competitors include Visa s Interlink, STAR, and MasterCard s Maestro. American Express is a particularly strong competitor to Diners Club as both cards significantly target international business travelers.

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

For discussion of the risks we face with respect to competition, see Risk Factors.

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Intellectual Property

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

Employees

As of January 15, 2011, we employed approximately 10,300 individuals.

Risk Management

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

Enterprise Risk Management Principles

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

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

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

Independence. We maintain independent risk and control functions including Corporate Risk Management, Law and Compliance, and Internal Audit. Our Corporate Risk Officer, who leads our Corporate Risk Management function, is appointed by our board of directors and is accountable for providing an independent perspective on the risks to which we are exposed; how well management is identifying, assessing and managing risk; and the capabilities we have in place to manage risk across the enterprise.

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

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

Risk Management Roles and Responsibilities

Responsibility for risk management is held at several different levels, including our board of directors, the Audit and Risk Committee of our board of directors, our Risk Committee, our Chief Executive Officer, our Executive Committee and our Corporate Risk Officer.

Board of Directors. Our board of directors approves certain risk management policies and our risk appetite and strategic limit framework. Our board also oversees our strategic plan and appoints our Corporate Risk Officer. In addition, our board receives and reviews Federal Reserve examination reports, as well as information regarding other examinations and communications from regulators to the extent they relate to risk management matters.

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

Risk Committee. Our Risk Committee is a management-level committee, authorized by the Audit and Risk Committee of our board of directors and chaired by our Corporate Risk Officer, that provides a forum for key members of our executive management team to review and discuss credit, market, liquidity, operational, legal and compliance and strategic risks across the company and for each business unit. Risk Committee membership consists of all members of the Executive Committee and the Corporate Risk Officer. The Committee regularly reports to the Audit and Risk Committee of our board of directors on risks and risk management. Our Risk Committee has formed a number of committees to assist it in carrying out its responsibilities. Each committee is guided by a charter that defines the mandates of the committee in further detail. These committees, made up of representatives from senior levels of management, escalate issues to our Risk Committee as necessary. These risk management committees include the Asset/Liability Management Committee, the Capital Planning Committee, the Counterparty Credit Committee, the Discover Bank Credit Committee, the Discover Bank Pricing Committee, the Payment Services Steering Committee, the New Initiatives Committee, the Operational Risk Committee and the Privacy and Policy Committee.

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

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

Corporate Risk Officer. Our Corporate Risk Officer chairs our Risk Committee and manages our Corporate Risk Management function. Our Corporate Risk Officer is responsible for establishing and implementing standards for the identification, management, measurement and reporting of risk on an enterprise-wide basis.

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

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

Risk Appetite and Strategic Limit Structure

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

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

The expressions of risk appetite and strategic limits also serve as tools to preclude business activities that are inconsistent with our long-term goals. Our risk appetite and strategic limit structure is approved by our board of directors.

Risk Categories

Our risk management program is organized around six major risk categories: credit risk, market risk, liquidity risk, operational risk, legal and compliance risk and strategic risk. We evaluate the potential impact of a risk event on the company by assessing financial impact, impact to our reputation, legal and regulatory impact and client/customer impact.

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

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

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

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

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

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

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

Compliance and Legal Risk. Compliance risk is the operational risk of legal or regulatory sanctions, financial loss or damage to reputation resulting from failure to comply with laws, regulations, rules, other regulatory requirements, or codes of conduct and other standards of self-regulatory organizations applicable to us. Legal risk arises from the potential that unenforceable contracts, lawsuits or adverse judgments can disrupt or otherwise negatively affect our operations or condition. These risks are inherent in all of our businesses. Both compliance and legal risk are sub-sets of operational risk but are recognized as a separate and complementary risk category by us given their importance to us and the specific capabilities and resources we deploy to manage these risk types effectively.

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

Strategic Risk. Strategic risk can arise from adverse business decisions, improper implementation of decisions, unanticipated economic events, failure to anticipate and respond to industry changes (including regulatory and legislative changes), failure to create and maintain a competitive business model, and failure to attract and profitably serve customers. Our Executive Committee actively manages strategic risk through the development, implementation and oversight of our business strategies, including the development of budgets and business plans. Our business units take and are accountable for managing strategic risk in pursuit of their objectives. Various policies govern the management of our strategic risk. In addition, the assessment of strategic risk is an important consideration of various sub-committees of our Risk Committee. For example, the strategic and other risks associated with new products or services are reviewed and reported on by our New Initiatives Committee and our Payment Services Steering Committee.

Our Corporate Risk Management function also plays an important role in the management of strategic risk by: (i) overseeing the objective setting and strategic planning processes from a risk perspective, to gain comfort that strategic risks have been adequately considered in the setting of objectives and development of strategies; (ii) providing an independent risk perspective to the new initiatives process; and (iii) assessing if there is effective alignment of management s proposed long-term strategic objectives with the risk appetite and strategic limits approved by our board of directors.

Risk Management Review of Compensation

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

Supervision and Regulation

General

Our operations are subject to extensive regulation, supervision and examination under U.S. federal, state and foreign laws and regulations. We are a bank holding company under the Bank Holding Company Act of 1956 (BHC Act) and a financial holding company under the Gramm-Leach-Bliley Act (GLBA), subject to the supervision, examination and regulation of the Federal Reserve Board (Federal Reserve).

Permissible activities for a bank holding company include those activities that are so closely related to banking as to be a proper incident thereto such as consumer lending and other activities that have been approved by the Federal Reserve

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by regulation or order. Certain servicing activities are also permissible for a bank holding company if conducted for or on behalf of the bank holding company or any of its affiliates. Impermissible activities for bank holding companies include activities that are related to commerce such as retail sales of nonfinancial products.

A financial holding company and the non-bank companies under its control are permitted to engage in activities considered financial in nature; incidental to financial activities; or complementary to financial activities if the Federal Reserve determines that they pose no risk to the safety or soundness of depository institutions or the financial system in general.

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

Federal Reserve regulations and the Federal Deposit Insurance Act, as amended by the Reform Act, require that bank holding companies serve as a source of strength to each subsidiary bank and commit resources to support each subsidiary bank. This support may be required at times when a bank holding company may not be able to provide such support without adversely affecting its ability to meet other obligations.

The Reform Act, which was enacted in July 2010, addresses risks to the economy and the payments system, especially those posed by large systemically significant financial firms (including bank holding companies with assets of at least $50 billion, which would include us). The Reform Act could have a significant impact on us by, for example, requiring us to change our business practices, requiring us to establish more stringent capital, liquidity and leverage ratio requirements, limiting our ability to pursue business opportunities, imposing additional costs on us, or otherwise adversely affecting our businesses. For more information regarding the Reform Act, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Risk Factors.

Banking Subsidiaries

We operate two banking subsidiaries, each of which is in the United States. Discover Bank offers credit card loans, student loans and personal loans, as well as certificates of deposit, savings accounts and other type of deposit accounts. Discover Bank is chartered and regulated by the Office of the Delaware State Bank Commissioner (the Delaware Commissioner), and also regulated by the Federal Deposit Insurance Corporation (FDIC), which insures its deposits and serves as the bank s federal banking regulator. Our other bank, Bank of New Castle, is chartered and regulated by the Delaware Commissioner, and also regulated by the FDIC, which insures its deposits.

Dividends

There are various federal and state law limitations on the extent to which Discover Bank can finance or otherwise supply funds to us through dividends, loans or otherwise. These limitations include minimum regulatory capital requirements, federal and state banking law requirements concerning the payment of dividends out of net profits or surplus, and general federal and state regulatory oversight to prevent unsafe or unsound practices. In general, federal and applicable state banking laws prohibit, without first obtaining regulatory approval, insured depository institutions, such as Discover Bank, from making dividend distributions if such distributions are not paid out of available earnings or would cause the institution to fail to meet applicable capital adequacy standards.

Additionally, regulatory guidance requires that we inform and consult with the Federal Reserve before increasing our quarterly dividend or declaring and paying a dividend that could raise safety and soundness concerns; for example, declaring and paying a dividend that exceeds earnings for the period for which the dividend is paid.

Capital

We, Discover Bank and Bank of New Castle are subject to capital adequacy guidelines adopted by federal banking regulators. For a further discussion of the capital adequacy guidelines, see Management s Discussion and Analysis of

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Financial Condition and Results of Operations Liquidity and Capital Resources. As a bank holding company, we are required to maintain minimum capital ratios. Currently, we are required to maintain Tier 1 and total capital equal to at least 4% and 8% of our total risk-weighted assets, respectively. We are also required to maintain a minimum leverage ratio (Tier 1 capital to adjusted total assets) of 4% to 5%, depending upon criteria defined and assessed by the Federal Reserve. At November 30, 2010, Discover Financial Services met all requirements to be deemed well-capitalized.

The Basel Committee on Banking Supervision released two consultative documents proposing significant changes to bank capital and leverage requirements in December 2009, commonly referred to as Basel III, and released the Basel III rules text in December 2010. Implementation of Basel III in the U.S. will require U.S. banking regulators to adopt regulations and guidelines, which may differ in significant ways from the recommendations published by the Basel Committee. It is unclear how U.S. banking regulators will define well-capitalized in their implementation of Basel III. For a further discussion of Basel III, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments International Initiatives Related to Capital and Liquidity.

The Reform Act also includes provisions related to increased capital requirements. Such provisions would establish minimum leverage and risk-based capital requirements on a consolidated basis for all depository institution holding companies and insured depository institutions that cannot be quantitatively less than the strictest requirements in effect for depository institutions as of the date of enactment of the Reform Act (i.e., July 21, 2010).

We are not able to predict at this time the precise content of capital guidelines or regulations that may be adopted by regulatory agencies having authority over us and our subsidiaries or the impact that any changes in regulation would have on us. However, we expect that the new standards will generally require us or our banking subsidiaries to maintain more capital, with common equity as a more predominant component, which could significantly impact our return on equity, financial condition, operations, capital position and ability to pursue business opportunities.

FDIA

The Federal Deposit Insurance Act (the FDIA) imposes various requirements on insured depository institutions. For example, the FDIA requires, among other things, the federal banking agencies to take prompt corrective action in respect of depository institutions that do not meet minimum capital requirements. The FDIA sets forth the following five capital tiers: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A depository institution s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors that are established by regulation. At November 30, 2010, Discover Bank and Bank of New Castle met all applicable requirements to be deemed well-capitalized. As noted above, Basel III and the Reform Act could alter the capital adequacy framework for participating banking organizations.

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

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

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

The FDIA prohibits a bank from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in its normal market area or nationally (depending upon where the deposits are solicited), unless (1) it is well-capitalized or (2) it is adequately capitalized and receives a waiver from the FDIC. A bank that is adequately capitalized and that accepts brokered deposits under a waiver from the FDIC may not pay an interest rate on any deposit in excess of 75 basis points over certain prevailing market rates. There are no such restrictions under the FDIA on a bank that is well-capitalized. As of November 30, 2010, Discover Bank and Bank of New Castle each met the FDIC s definition of a well-capitalized institution for purposes of accepting brokered deposits. An inability to accept brokered deposits in the future could materially adversely impact our funding costs and liquidity. For more information, see Risk Factors *An inability to accept or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business.*

The Reform Act requires that the FDIC conduct a study on, among other things, (i) the potential impact on the Deposit Insurance Fund of revising the definitions of brokered deposits and core deposits to better distinguish between them and (ii) an assessment of the differences between core deposits and brokered deposits and their role in the economy and banking sector of the United States and report on the results of the study, including any legislative recommendations, to address concerns arising in connection with the definitions of core deposits and brokered deposits. We are not able to predict at this time whether any regulations would be revised as a result of such study or the impact that any changes in regulation would have on us.

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

Investment in Discover

Because Discover Bank and Bank of New Castle are each insured depository institutions, and we are a bank holding company, certain acquisitions of our voting stock may be subject to regulatory approval or notice under U.S. Federal or Delaware law. Investors are responsible for ensuring that they do not, directly or indirectly, acquire shares of our stock in excess of the amount which can be acquired without regulatory approval under the Change in Bank Control Act, the BHCA and the Delaware Change in Bank Control provisions, which prohibit any person or company from acquiring control of us without, in most cases, the prior written approval of each of the FDIC, the Federal Reserve and the Delaware Commissioner.

Consumer Lending Regulation

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

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

The Credit Card Accountability Responsibility and Disclosure Act of 2009 (the CARD Act) was enacted in May 2009. The CARD Act made numerous changes to the Truth in Lending Act, affecting the marketing, underwriting, pricing, billing and other aspects of the consumer credit card business. Several provisions of the CARD Act became effective in August 2009, but most of the requirements became effective in February 2010 and in August 2010. For more information, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Risk Factors *The Credit Card Accountability Responsibility and Disclosure Act of 2009 restricts our business practices and negatively impacts our results of operations.*

The Reform Act established the Bureau of Consumer Financial Protection (the BCFP) within the Federal Reserve, which will regulate consumer credit. On July 21, 2011, many consumer financial protection functions currently assigned to the federal banking and other designated agencies will shift to the BCFP. The BCFP will have broad rulemaking authority over providers of credit, savings and payment services and products. The BCFP will be directed to prevent unfair, deceptive or abusive practices and ensure that all consumers have access to markets for consumer financial products and services, and that such markets are fair, transparent and competitive. The BCFP will have rulemaking and interpretive authority under existing and future consumer financial services laws and broad supervisory, examination and enforcement authority over large providers of consumer financial products and services, such as us. State officials will be authorized to enforce consumer protection rules issued by the BCFP. For more information, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Risk Factors *The new Bureau of Consumer Financial Protection may increase our compliance costs and have a significant impact on our business.*

Electronic Funds Networks; Data Privacy

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

In addition, the Reform Act requires, effective July 21, 2011, that interchange fees paid to or charged by payment card issuers on debit card transactions be reasonable and proportional to the issuer s cost in connection with authorization, clearance or settlement of such transactions. The Reform Act directs the Federal Reserve to enact rules to implement this requirement and to prohibit debit card networks and issuers from requiring debit card transactions to be processed solely on a single payment network or two or more affiliated networks. Further, the Reform Act prohibits credit/debit network rules that restrict merchants from offering discounts to customers in order to encourage them to use a particular form of payment, or from setting minimum transaction amounts of $10.00 or less for use of credit cards, as long as such merchant practices do not differentiate on the basis of the issuer or network. The impact of these provisions on the debit card market and the PULSE network will depend upon Federal Reserve implementing regulations, the actions of our competitors, and the behavior of other marketplace participants. The Federal Reserve issued proposed regulations for comment in December 2010, and we are currently evaluating the proposal. The provisions applicable to the debit card market may adversely affect PULSE s business practices, network transaction volume, revenue, and prospects for future growth. For more information, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Risk Factors *Recent legislative and regulatory reforms related to the debit card market may have a significant impact on our PULSE network business and may result in decreases in our PULSE network volume and revenue.*

Money Laundering & Terrorist Financing Prevention Program

We maintain an enterprise-wide program designed to comply fully with all applicable anti-money laundering and anti-terrorism laws and regulations, including the Bank Secrecy Act and the USA PATRIOT Act of 2001. This program includes policies, procedures, training and other internal controls designed to mitigate the risk of money laundering or terrorist financing posed by our products, services, customers and geographic locale. These controls include procedures and

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processes to detect and report suspicious transactions, perform customer due diligence, and meet all recordkeeping and reporting requirements related to particular transactions involving currency or monetary instruments. The program is coordinated by a compliance officer and undergoes an annual, independent audit to assess its effectiveness.

Sanctions Programs

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

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Executive Officers of the Registrant

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

Name	Age	Position
David W. Nelms	49	Chairman and Chief Executive Officer
Roger C. Hochschild	46	President and Chief Operating Officer
Roy A. Guthrie(1)	57	Executive Vice President and Chief Financial Officer
Kathryn McNamara Corley	50	Executive Vice President, General Counsel and Secretary
Carlos Minetti	48	Executive Vice President, President Consumer Banking and Operations
Diane E. Offereins	53	Executive Vice President, President Payment Services
James V. Panzarino	58	Executive Vice President and Chief Credit Risk Officer
Glenn Schneider	49	Senior Vice President and Chief Information Officer
Harit Talwar	50	Executive Vice President, President U.S. Cards

(1) On October 6, 2010, Roy A. Guthrie announced his intent to retire in the summer of 2011.

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

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

Roy A. Guthrie has served as Executive Vice President and Chief Financial Officer since 2005. Prior to joining us, Mr. Guthrie was President, Chief Executive Officer of CitiFinancial International, LTD, a Consumer Finance Business of Citigroup, from 2000 to 2004. In addition Mr. Guthrie served on Citigroup s Management Committee during this period of time. Mr. Guthrie served as Chief Financial Officer of Associates First Capital Corporation from 1996 to 2000, while it was a public company and served as a member of its board from 1998 to 2000. Mr. Guthrie holds a Bachelor s degree in Economics from Hanover College and an M.B.A. from Drake University.

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

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

Diane E. Offereins has served as Executive Vice President, President Payment Services since April 2010. Prior thereto, she had been Executive Vice President, Payment Services since December 2008 and Executive Vice President and

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Chief Technology Officer since 1998. In addition, she was appointed to oversee the PULSE network in 2006. From 1993 to 1998, Ms. Offereins was at MBNA America Bank, most recently as Senior Executive Vice President. Ms. Offereins holds a Bachelor of Business Administration degree in Accounting from Loyola University.

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

Glenn Schneider has served as Senior Vice President and Chief Information Officer since December 2008, and was appointed to our Executive Committee in December 2009. From 2003 to 2008, he was Senior Vice President, Application Development, and from 1998 to 2003, he served as Vice President, Marketing Applications. Mr. Schneider joined us in 1993. He holds a bachelor s degree in Economics/Computer Science and a minor in Statistics from Northern Illinois University.

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

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Item 1A. Risk Factors

You should carefully consider each of the following risks described below and all of the other information in this annual report on Form 10-K in evaluating us. Our business, financial condition, cash flows and/or results of operations could be materially adversely affected by any of these risks. The trading price of our common stock could decline due to any of these risks.

This annual report on Form 10-K also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this annual report on Form 10-K. See Special Note Regarding Forward-Looking Statements, which immediately follows the risks below.

Certain historical numbers from 2009 in this section are shown on an as adjusted basis. The as-adjusted basis assumes that the trusts used in our securitization activities were consolidated into our financial results and excludes from results income received in connection with the antitrust litigation settlement in 2009. For an explanation as to why management believes that the as adjusted numbers are useful to investors and for a reconciliation of these numbers, see Management s Discussion and Analysis of Financial Condition and Results of Operations Reconciliation of GAAP to As Adjusted Data.

Economic conditions could have a material adverse effect on our business, results of operations, financial condition and stock price.

Economic conditions have adversely affected unemployment rates, home values, consumer spending and the availability of consumer credit. These factors, along with an already high level of consumer indebtedness, have adversely affected the ability and willingness of customers to pay amounts owed to us. Although delinquencies and charge-offs have improved in 2010, they remain higher than pre-recession levels. The over 30 days delinquent rate was 3.89% at November 30, 2010, down from 5.31% at November 30, 2009 as adjusted, and the full-year net charge-off rate was 7.57% for 2010, down from 7.77% for 2009, as adjusted. Our business is always influenced by economic conditions. Poor economic conditions not only affect the ability and willingness of customers to pay amounts owed to us, increasing our provision for loan losses and charge-offs, but can also reduce the usage of our cards, the number of transactions on our cards and the average purchase amount of transactions on our cards, which reduces transaction fees and interest income. We rely heavily on our credit card business to generate earnings. Our interest income from credit card loans was $5.8 billion for the 2010 fiscal year, which was 88% of revenues (defined as net interest income plus other income). Our interest income from credit card loans was $6.2 billion in the 2009 fiscal year, as adjusted. Economic conditions may also cause our earnings to fluctuate and diverge from expectations of analysts and investors, who may have differing assumptions regarding their impact on our business and, therefore, may impact the trading price of our common stock.

Recent legislative and regulatory reforms may have a significant impact on our business, results of operations and financial condition.

In July 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Reform Act), which contains a comprehensive set of provisions designed to govern the practices and oversight of financial institutions and other participants in the financial markets. For example, the Reform Act addresses risks to the economy and the payments system posed by large systemically significant financial firms, including us, through a variety of measures, including increased capital and liquidity requirements, limits on leverage and enhanced supervisory authority. A more comprehensive description of the Reform Act and other recent legislative and regulatory initiatives that may affect us is contained in Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments.

The full impact of the Reform Act is difficult to assess because many provisions require federal agencies to adopt implementing regulations. In addition, the Reform Act mandates multiple studies, which could result in additional legislative or regulatory action. The Reform Act, as well as other legislative and regulatory changes, could have a significant impact on us by, for example, requiring us to change our business practices, requiring us to meet more stringent capital, liquidity and leverage ratio requirements (including those under Basel III), limiting our ability to pursue business opportunities, imposing additional costs on us, limiting fees we can charge for services, impacting the value of our assets, or otherwise adversely affecting our businesses. The effect of the Reform Act on our business and operations

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could be significant, depending upon final implementing regulations, the actions of our competitors and the behavior of other marketplace participants. In addition, we may be required to invest significant management time and resources to address the various provisions of the Reform Act and the numerous regulations that are required to be issued under it. The Reform Act and any related legislation or regulations could have a material adverse effect on our business, results of operations and financial condition.

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

The Reform Act creates a new federal regulatory agency, the Bureau of Consumer Financial Protection (the BCFP). Headed by a single Director and not subject to the Congressional appropriations/oversight process, the BCFP is expected to have a large budget and staff, and has broad authority with respect to most of the businesses in which we engage. It will write regulations under federal consumer financial protection laws, and enforce those laws against and examine large financial institutions like us for compliance. It will collect fines and provide consumer restitution in the event of violations, engage in consumer financial education, track consumer complaints, request data and promote the availability of financial services to underserved consumers and communities. It has authority to prevent unfair, deceptive or abusive practices by issuing regulations or by using its enforcement authority without first establishing regulatory guidance.

Depending on how the BCFP functions and its areas of focus, it could have a material adverse impact on our businesses. For example, the BCFP is expected to establish multiple divisions, each with its own rule writing and compliance examination specialists, to focus on businesses in which we engage (such as revolving loans, other consumer loans, and payments). In addition to increasing our compliance costs and potentially delaying our ability to respond to marketplace changes, this could result in requirements to alter our products and services that would make our products less attractive to consumers and impair our ability to offer them profitably. Should the BCFP discourage the use of products we offer or steer consumers to other products or services that it deems to be preferable, we could suffer reputational harm and a loss of customers. The BCFP s authority to change regulations adopted in the past by other regulators (e.g., regulations issued under the Truth in Lending Act or the CARD Act (defined below) by the Federal Reserve), or to rescind or ignore past regulatory guidance, could increase our compliance costs and litigation exposure.

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

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

The Reform Act contains several provisions that may adversely affect PULSE s business practices, network transaction volume, revenue, and prospects for future growth. First, the Reform Act will require that interchange fees paid to or charged by payment card issuers on debit card transactions be reasonable and proportional to the issuer s cost in connection with authorization, clearance or settlement of such transactions. The Federal Reserve also has the power to regulate network fees to the extent necessary to prevent circumvention of interchange regulation under the Reform Act. These requirements may significantly affect the debit card market, decrease prospects for future growth of debit products, negatively impact PULSE s transaction volume and revenue, and require costly system changes. Our transaction processing revenue was $150 million and $125 million for the years ended November 30, 2010 and 2009, respectively. The Reform Act also requires Federal Reserve rulemaking to restrict debit card networks and issuers from requiring debit card transactions to be processed solely on a single payment network or two or more affiliated networks, or from requiring that transactions be routed over certain networks. This restriction will impact PULSE s ability to enter into exclusivity arrangements, which will affect PULSE s current business practices and may materially adversely affect its network transaction volume and revenue. The impact of these provisions on PULSE will depend upon Federal Reserve implementing regulations, the actions of our competitors, and the behavior of other marketplace participants. The Federal Reserve issued proposed regulations for comment in December 2010, and we are currently evaluating the proposal.

The Credit Card Accountability Responsibility and Disclosure Act of 2009 restricts our business practices and negatively impacts our results of operations.

The Credit Card Accountability Responsibility and Disclosure Act of 2009, or the CARD Act, has required us to make fundamental changes to many of our business practices, including marketing, underwriting, pricing and billing. For example, the CARD Act s restrictions on our ability to increase interest rates on existing balances to respond to market conditions and credit risk ultimately limits our ability to extend credit to new customers and provide additional credit to current customers. In addition, the CARD Act s requirement to allocate payments on accounts in excess of the minimum payment due to balances with the highest annual percentage rates before balances with lower annual percentage rates has and will continue to reduce our interest income. Also, the CARD Act s requirement to review and, in some cases, adjust annual percentage rate increases since January 1, 2009, which became effective in August 2010, will result in reduced interest income. We rely heavily on interest income. Our interest income from credit card loans was $5.8 billion for the 2010 fiscal year, which was 88% of revenues (defined as net interest income plus other income), compared to $6.2 billion in the 2009 fiscal year, as adjusted. The CARD Act s restrictions on late and other penalty fees have reduced our loan fee income and may impact our ability to deter late payments. Our loan fee income was $340 million for the 2010 fiscal year, which was 5% of revenues, compared to $494 million in the 2009 fiscal year, as adjusted.

We have made changes to our pricing, credit and marketing practices designed to lessen the impact of the changes required by the CARD Act. The long-term impact of the CARD Act on credit card industry profitability generally, and on our business practices and revenues, will depend upon consumer behavior and the actions of our competitors, which remain difficult to predict. Consumers may generally choose to use credit cards less frequently or for smaller dollar amounts. We may have to reconsider certain strategies in order to remain competitive. For example, in the event of another market downturn, we may have to consider expense-reduction initiatives in order to offset our inability to generate increased interest and fee income due to the CARD Act s repricing restrictions. If the changes we have made and may make in the future to offset the impact of the CARD Act are not effective in the long term, they may have a material adverse effect on our business and results of operations.

We face competition from other credit card issuers, and we may not be able to compete effectively, which could result in fewer customers and lower account balances and could materially adversely affect our financial condition, cash flows and results of operations.

The credit card issuing business is highly competitive. We compete with other credit card issuers on the basis of a number of factors, including brand, reputation, rewards programs, customer service, merchant acceptance, product offerings, incentives and pricing. This competition affects our ability to obtain applicants for our credit cards, increase usage of our credit cards, maximize the revenue generated by card usage and generate customer loyalty and satisfaction so as to minimize the number of customers switching to other credit card brands or debit cards. Competition is also increasingly based on the value provided to the customer by rewards programs. Many credit card issuers have instituted rewards programs that are similar to ours, and issuers may in the future institute rewards programs that are more attractive to customers than our programs.

In addition, because most domestically issued credit cards, other than those issued by American Express, are issued on the Visa and MasterCard networks, most other card issuers benefit from the dominant position and marketing and pricing power of Visa and MasterCard. If we are unable to compete successfully, or if competing successfully requires us to take aggressive actions in response to competitors actions, our financial condition, cash flows and results of operations could be materially adversely affected.

We incur considerable expenses in competing with other credit card issuers, and many of our competitors have greater scale, which may place us at a competitive disadvantage and negatively affect our financial results.

We incur considerable expenses in competing with other credit card issuers to attract and retain customers and increase card usage. A substantial portion of these expenses relates to marketing expenditures. We incurred expenses of $463 million and $406 million in the 2010 and 2009 fiscal years, respectively, for marketing and business development. Because of the highly competitive nature of the credit card issuing business, a primary method of competition among credit card issuers, including us, has been to offer rewards programs, low introductory interest rates, attractive standard purchase rates and balance transfer programs that offer a favorable annual percentage rate or other financial incentives for a specified length of time on account balances transferred from another credit card. This type of competition has adversely affected credit card yields, and customers may frequently switch credit cards or transfer their balances to another card. There can be no assurance that any of the expenses we incur or incentives we offer to attempt to acquire and maintain accounts and increase card usage will be effective.

Furthermore, many of our competitors are larger than we are, have greater financial resources than we do and/or have lower capital, funding and operating costs than we have and expect to have, and have assets such as branch locations and co-brand relationships that may help them compete more effectively. We may be at a competitive disadvantage as a result of the greater scale of many of our competitors.

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

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

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

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

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

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

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

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

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

The success of our Diners Club business depends upon our ability to maintain the full operability of the Diners Club network for existing Diners Club cardholders, network licensees and merchants. While a significant portion of Diners Club support functions were successfully moved to us from Citigroup in 2010, we continue to rely on the assistance of Citigroup during a transition period for certain network and operational support services. If we were to lose the assistance of Citigroup, we may face difficulty maintaining operations at the same level. In addition, Citigroup owns and operates network licensees generating a significant share of the Diners Club network sales volume. Citigroup has been reducing assets outside its core businesses, including certain Diners Club businesses, by selling its ownership interest. If Citigroup were to discontinue its support of a significant number of or key Diners Club network licensees, we may face difficulty maintaining and growing our international network.

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

We rely upon numerous other network partners for merchant acceptance for existing Diners Club customers. We have rerouted almost all merchant transactions for foreign Diners Club cards transacting in North America from the MasterCard acceptance network to the Discover Network, and we expect to complete this transition in 2011. If we are unable to continue to offer acceptable North American merchant acceptance to Diners Club customers, we may experience decreased transaction volume, which would reduce our revenues. The long-term success of our acquisition of Diners Club depends upon achieving card acceptance across our networks, which could include higher overall costs or longer timeframes than anticipated. If we are unable to successfully achieve card acceptance across our networks, we may be unable to achieve the synergies we anticipate and grow our business internationally.

The success of our acquisition of The Student Loan Corporation depends upon our ability to maintain the full operability of and integrate the new business. If we fail to do so, we may be unable to sustain and grow our student loan business.

On December 31, 2010, we purchased The Student Loan Corporation (SLC), which significantly increased the size of our student loan business, adding approximately $4.0 billion in private student loans (before the application of purchase accounting) to our portfolio of $1.0 billion of private student loans at November 30, 2010. The success of this acquisition depends upon our ability to maintain the SLC business at its current level and manage the risks resulting from our relatively recent entry into the student loan market. We are relying heavily on the assistance of Citibank, N.A. (Citi) and certain of its affiliates during a transition period for many services to help us transition and integrate the new business, including services related to operations, technology, marketing and origination. We are also relying on key personnel from Citi and SLC in the transition process. The ability to maintain operations at current levels would be adversely impacted if we were to lose the support of Citi or key personnel. If we were to lose the support of Citi, we could experience interruptions in operations that could negatively impact our ability to meet customer demand for student loan originations and disbursements, damage our relationships with schools, customers and vendors, and reduce our market share in the student loan market, all of which could adversely affect our student loan business and results of operations.

The long-term success of our student loan business depends upon our ability to manage the credit risk, pricing, funding and expenses of a larger student loan portfolio. Our ability to maintain or increase market share is largely dependent upon our ability to offer competitively priced, desirable loan products, as well as our ability to communicate effectively to prospective borrowers and schools about these products. We plan to continue to offer competitively priced products by managing our expenses through building economies of scale, which will reduce our origination and servicing costs. If we are unable to integrate the new business well and at a reasonable cost, it may have a negative impact on our results of operations, affect our competitive position in the marketplace and prevent us from sustaining and growing our student loan business.

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

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

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

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

Our ability to manage credit risk and avoid high charge-off rates may be adversely affected by economic conditions that may be difficult to predict. The full-year net charge-off rate was 7.57% in 2010, down from the full-year net charge-off rate of 7.77% in 2009, as adjusted. At November 30, 2010 and 2009 as adjusted, $1.2 billion, or 2.42%, and $1.7 billion, or 3.26%, of our loan receivables were non-performing (defined as loans over 90 days delinquent and accruing interest plus loans not accruing interest). Although credit performance improved in 2010, we remain subject to conditions in the consumer credit environment. There can be no assurance that our underwriting and portfolio management strategies will permit us to avoid high charge-off levels, or that our provision for loan losses will be sufficient to cover actual losses.

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

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

We have expanded our marketing of our personal and private student lending products. Our personal and private student loan portfolios grew to $1.9 billion and $1.0 billion, respectively, at November 30, 2010, compared to $1.4 billion and $0.6 billion, respectively, at November 30, 2009. In addition, we acquired approximately $4.0 billion in private student loans (before the application of purchase accounting) in connection with our acquisition of The Student Loan Corporation on December 31, 2010. We have less experience in these areas as compared to our traditional credit card lending business, and there can be no assurance that we will be able to grow these products in accordance with our strategies, manage our credit risk or generate sufficient revenue to cover our expenses in these markets. Our failure to manage our credit risks may materially adversely affect our profitability and our ability to grow these products, limiting our ability to further diversify our business.

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

We must effectively manage the liquidity risk to which we are exposed. We require liquidity in order to meet cash requirements such as day-to-day operating expenses, extensions of credit on our consumer loans and required payments of principal and interest on our borrowings. Our primary sources of liquidity and funding are payments on our credit card loan receivables, deposits and proceeds from securitization transactions and securities offerings. We may maintain too much liquidity, which can be costly and limit financial flexibility, or we may be too illiquid, which could result in financial distress during a liquidity stress event.

Our liquidity investment portfolio had a balance of approximately $10.1 billion as of November 30, 2010, compared to $14.5 billion as of November 30, 2009. We decreased our liquidity investment portfolio following an elevated level of asset-backed securities and deposit maturities in the first half of 2010. Our total contingent liquidity sources as of November 30, 2010 amounted to $22.5 billion, consisting of $10.1 billion in our liquidity investment portfolio, $6.7 billion in incremental Federal Reserve discount window capacity, $2.4 billion in a revolving credit facility, and $3.3 billion of undrawn capacity in private securitizations. Our total contingent liquidity sources as of November 30, 2009 were $23.2 billion.

In the event that our current sources of liquidity do not satisfy our needs, we would be required to seek additional financing. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit to the financial services industry and our credit ratings. Disruptions, uncertainty or volatility in the capital, credit or deposit markets may limit our ability to replace maturing liabilities in a timely manner and satisfy other funding requirements. As such, we may be forced to delay raising funding, issue shorter-term securities than desired, or bear an unattractive cost of funding, which could decrease profitability and significantly reduce financial flexibility. Further, in disorderly financial markets or for other reasons, it may be difficult or impossible to liquidate some of our investments to meet our liquidity needs.

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

We obtain deposits from consumers either directly or through affinity relationships (direct-to-consumer deposits) and through third-party securities brokerage firms that offer our deposits to their customers (brokered deposits). We have increased and plan to continue to increase our direct-to-consumer deposit funding. We had $20.6 billion in direct-to-consumer deposits and $13.7 billion in brokered deposits as of November 30, 2010, compared to $12.6 billion in direct-to-consumer deposits and $19.5 billion in brokered deposits as of November 30, 2009.

Competition from other financial services firms that use deposit funding may affect deposit renewal rates, costs or availability. If we are required to offer higher interest rates to attract or maintain deposits, our funding costs will be adversely impacted. In addition, our ability to maintain existing or obtain additional deposits may be impacted by factors beyond our control, including perceptions about our financial strength or online banking generally, which could reduce the number of consumers choosing to make deposits with us, third parties continuing or entering into affinity relationships with us, or third-party securities brokerage firms offering our deposit products.

Our ability to obtain deposit funding and offer competitive interest rates on deposits is also dependent on capital levels of our bank subsidiaries. The FDIA prohibits a bank, including our subsidiary Discover Bank, from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in its normal market area or nationally (depending upon where the deposits are solicited), unless (1) it is well-capitalized or (2) it is adequately capitalized and receives a waiver from the FDIC. A bank that is adequately capitalized may not pay an interest rate on any deposit, including direct-to-consumer deposits, in excess of 75 basis points over the national rate published by the FDIC. There are no such restrictions on a bank that is well-capitalized. While Discover Bank met the FDIC s definition of well-capitalized as of November 30, 2010, there can be no assurance that it will continue to meet this definition. For a comparison of Discover Bank s capital ratios to the well-capitalized capital requirements, see Note 19: Capital Adequacy to our consolidated financial statements. Additionally, our regulators can adjust the requirements to be well-capitalized at any time and have authority to place limitations on our deposit businesses, including the interest rate we pay on deposits.

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

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

Historically, we have used the securitization of credit card receivables, which involves the transfer of receivables to a trust and the issuance by the trust of beneficial interests to third-party investors, as a significant source of funding. Our average level of securitized borrowings from third parties was $17.2 billion for fiscal year 2010 and $22.7 billion for fiscal year 2009. Due to market events and disruption in the capital markets as well as uncertainty related to various regulatory initiatives impacting the asset-backed securitization markets, we have been less active in the public and private securitization markets since mid-2008 and it is uncertain whether the securitization markets will be available in the future on terms or volumes that are similar to historical levels.

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

The SEC has also proposed revised rules for asset-backed securities offerings that, if adopted, would substantially change the disclosure, reporting and offering process for public and private offerings of asset-backed securities. Significant changes to the disclosure requirements or registration process for securitizations could make them more expensive, making securitization less viable as a funding source.

The ability of issuers of asset-backed securities to obtain necessary credit ratings for their issuances has been based, in part, on qualification under the FDIC s safe harbor rule for assets transferred in securitizations. The FDIC recently issued a new Final Rule for its securitization safe harbor which requires issuers to comply with a new set of requirements in order to qualify for the safe harbor. Issuances out of our existing credit card securitization trusts are grandfathered under the new FDIC Final Rule. However, qualification for the safe harbor with respect to the securitization of any other assets, including student loans, would require us to satisfy the requirements of the FDIC s new Final Rule.

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

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

Our liquidity would be materially adversely affected by the occurrence of events that could result in the early amortization of our existing credit card securitization transactions. Credit card securitizations are normally structured as revolving transactions that do not distribute to securitization investors their share of monthly principal payments on the receivables during the revolving period, and instead use those principal payments to fund the purchase of replacement receivables. The occurrence of early amortization events may result in termination of the revolving periods of our securitization transactions, which would require us to repay the affected outstanding securitized borrowings over a period of a few months. Our average level of securitized borrowings was $17.2 billion for fiscal year 2010 and $22.7 billion for fiscal year 2009. Early amortization events include, for example, insufficient cash flows in the securitized pool of receivables to meet contractual requirements (also known as excess spread), certain breaches of representations, warranties or covenants in the agreements relating to the securitization and receivership or insolvency of Discover Bank. For more information on excess spread, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Securitization Financing. An early amortization event would negatively impact our liquidity, and require us to rely on alternative funding sources, which may or may not be available at the time.

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

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

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

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

We must effectively manage the risks of the investments in our liquidity investment portfolio, which is comprised of cash and cash equivalents and high quality, liquid investments. Our investments may be adversely affected by market fluctuations including changes in interest rates, prices, credit risk premiums and overall market liquidity. Also, investments backed by collateral could be adversely impacted by changes in the value of the underlying collateral. In addition, deteriorating economic conditions may cause certain of the obligors, counterparties and underlying collateral on our investments to incur losses of their own or default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons, thereby increasing our credit risk exposure to these investments. These risks could result in a decrease in the value of our investments, which could negatively impact our financial condition. Further, in an effort to increase the rate of return on our investment portfolio, we may choose new investments, which may increase our risk of loss. For example, during the fourth quarter 2010, we moved a portion of our liquidity investment portfolio into approximately $4 billion of U.S. Treasury, U.S. government agency and corporate debt securities guaranteed by the FDIC in order to pursue a higher return. While we expect these investments to be readily convertible into cash and do not believe they present a material increase to our risk profile or will have a material impact on our risk based capital ratios, they are subject to certain market fluctuations that may reduce the ability to fully convert into cash.

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

Changes in interest rates cause our interest expense to increase or decrease, as certain of our debt instruments carry interest rates that fluctuate with market benchmarks. If we are unable to pass any higher cost of funds to our customers, the increase in interest expense could materially reduce earnings. Some of our consumer loan receivables bear interest at a fixed rate or do not earn interest, and we may not be able to increase the rate on those loans to mitigate any higher cost of funds. At the same time, our variable rate loan receivables, which are based on the prime market benchmark rate, may not change at the same rate as our floating rate borrowings or may be subject to a cap, subjecting us to basis point risk. The majority of our floating rate borrowings are asset securitizations, which are generally based on the 1-month LIBOR rate. For example, if the prime rate were to decrease without a decrease in the 1-month LIBOR rate, our earnings would be negatively impacted. In addition to asset securitizations, we also utilize deposits as a significant source of funds. Although our interest costs associated with existing certificates of deposit are fixed, new deposit issuances are subject to fluctuations in interest rates.

Interest rates may also adversely impact our delinquency and charge-off rates. Many consumer lending products bear interest rates that fluctuate with certain base lending rates published in the market, such as the prime rate and LIBOR. As a result, higher interest rates often lead to higher payment requirements by consumers under obligations to us and other lenders, which may reduce their ability to remain current on their obligations to us and thereby lead to loan delinquencies and additions to our loan loss provision, which could materially adversely affect our earnings.

We regularly monitor interest rates and have entered into interest rate derivative agreements in an effort to manage our interest rate risk exposure. Changes in market assumptions regarding future interest rates could significantly impact the valuation of our derivative instruments and, accordingly, impact our financial position and results of operations. If our hedging activities are not appropriately monitored or executed, these activities may not effectively mitigate our interest rate sensitivity or have the desired impact on our results of operations or financial condition.

We have a credit facility that could restrict our operations.

We have a multi-year unsecured committed credit facility that currently has $2.4 billion available and contains restrictions, covenants and events of default. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Additional Funding Sources. Although we currently have no outstanding balances due under the facility, the terms of the facility impose certain restrictions and future indebtedness may impose various additional restrictions and covenants on us (such as tangible net worth requirements) that could have

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adverse consequences, including: limiting our ability to pay dividends to our stockholders; increasing our vulnerability to changing economic, regulatory and industry conditions; limiting our ability to compete and our flexibility in planning for, or reacting to, changes in our business and the industry; limiting our ability to borrow additional funds; and requiring us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing funds available for working capital, capital expenditures, acquisitions and other purposes.

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

A key element of our business strategy is to increase the usage of the Discover card by our customers, including making it their primary card, and thereby increase our revenue from transaction and service fees and interest income. However, our customers use and payment patterns may change because of social, legal and economic factors, and customers may decide to use debit cards instead of credit cards, not to increase card usage, or to pay the balances within the grace period to avoid finance charges. We face challenges from competing credit card products in our attempts to increase credit card usage by our existing customers. Our ability to increase card usage also is dependent on customer satisfaction, which may be adversely affected by factors outside of our control, including competitors actions and legislative/regulatory changes. The CARD Act limits pricing changes that may impact an account throughout its lifecycle, which may reduce our capability to offer lower price promotions to drive account usage and customer engagement. As part of our strategy to increase usage, we have been increasing the number of merchants who accept cards issued on the Discover Network. If we are unable to continue increasing merchant acceptance or fail to improve awareness of existing merchant acceptance of our cards, our ability to grow usage of Discover cards may be hampered. As a result of these factors, we may be unable to increase or sustain credit card usage, which could impair growth in, or lead to diminishing, average balances and total revenue.

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

Discover card transaction volume was concentrated among our top 100 merchants in 2010, with our largest merchant accounting for approximately 8% of that transaction volume. These merchants could seek to negotiate better pricing or other financial incentives by continuing to participate in the Discover Network only on the condition that we change the terms of their economic participation. Loss of acceptance at our largest merchants would decrease transaction volume, negatively impact our brand, and could cause customer attrition. At the same time, we are subject to increasing pricing pressure from third-party issuers as a result of the continued consolidation in the banking industry, which results in fewer large issuers that, in turn, generally have a greater ability to negotiate higher interchange fees. In addition, some of our merchants, primarily our remaining small and mid-size merchants, are not contractually committed to us for any period of time and may cease to participate in the Discover Network at any time on short notice.

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

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

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

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continue to participate with us if more attractive opportunities arise. If we are unable to continue to increase or maintain small and mid-size merchant acceptance, our competitive position and our ability to grow earnings could be adversely affected.

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

Merchant acceptance and fees are critical to the success of both our card issuing and payment processing businesses. Merchants are concerned with the fees charged by credit card and debit card networks. They seek to negotiate better pricing or other financial incentives as a condition to continued participation in the Discover Network and PULSE network. During the past few years, merchants and their trade groups have filed numerous lawsuits against Visa, MasterCard, American Express and their card issuing banks, claiming that their practices toward merchants, including interchange fees, violate federal antitrust laws. There can be no assurance that they will not in the future bring legal proceedings against other credit card and debit card issuers and networks, including us. Merchants also may promote forms of payment with lower fees, such as ACH-based payments, or seek to impose surcharges at the point of sale for use of credit or debit cards. Merchant groups have also promoted federal and state legislation that would restrict issuer practices or enhance the ability of merchants, individually or collectively, to negotiate more favorable fees. The heightened focus by merchants on the fees charged by credit card and debit card networks, together with the Reform Act and recent U.S. Department of Justice settlements with MasterCard and Visa, which would allow merchants to encourage customers to use other payment methods or cards, could lead to reduced transactions on, or merchant acceptance of, Discover Network or PULSE network cards or reduced fees, either of which could adversely affect our business, financial condition and results of operations.

Political, economic or other instability in a country or geographic region, or other unforeseen or catastrophic events, could adversely affect our international business activities and reduce our revenue.

Natural disasters or other catastrophic events, including terrorist attacks, may have a negative effect on our business and infrastructure, including our information technology systems. Our Diners Club network, concentrated on primarily serving the global travel industry, could be adversely affected by international conditions that may result in a decline in consumer or business travel activity. Armed conflict, public health emergencies, natural disasters or terrorism may have a significant negative effect on travel activity and related revenue. Although a regionalized event or condition may primarily affect one of our network participants, it may also affect our overall network activity and our resulting revenue. Overall network transaction activity may decline as a result of concerns about safety or disease or may be limited because of economic conditions that result in spending on travel to decline. The impact of such events and other catastrophes on the overall economy may also adversely affect our financial condition or results of operations.

If fraudulent activity associated with our cards or our networks increases, our brands could suffer reputational damage, the use of our cards could decrease and our fraud losses could be materially adversely affected.

We are subject to the risk of fraudulent activity associated with merchants, customers and other third parties handling customer information. Our fraud losses were $44 million and $58 million for the years ended November 30, 2010 and 2009, respectively. Credit and debit card fraud, identity theft and related crimes are prevalent and perpetrators are growing ever more sophisticated. Our resources and fraud prevention tools may be insufficient to accurately predict and prevent fraud. The risk of fraud is expected to increase as we expand the acceptance of the Discover card internationally and expand our direct-to-consumer deposit business. Our financial condition, the level of our fraud charge-offs and other results of operations could be materially adversely affected if fraudulent activity were to significantly increase. In addition, significant increases in fraudulent activity could lead to regulatory intervention (such as mandatory card reissuance) and reputational and financial damage to our brands, which could negatively impact the use of our cards and networks and thereby have a material adverse effect on our business. Further, fraudulent activity may result in lower license fee revenue from our Diners Club licensees.

If our security systems, or those of merchants, merchant acquirers or other third parties containing information about customers, are compromised, we may be subject to liability and damage to our reputation.

Our security protection measures or the security protections of third parties participating in our networks may not be sufficient to protect the confidentiality of information relating to customers or transactions processed on our networks.

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Customer data also may be stored on systems of third-party service providers and merchants that may have inadequate security systems. Third-party carriers regularly transport customer data, and may lose sensitive customer information. Unauthorized access to our networks or any of our other information systems potentially could jeopardize the security of confidential information stored in our computer systems or transmitted by our customers or others. As we increase acceptance of the Discover card internationally, we may experience additional risks related to security systems. If our security systems or those of merchants, processors or other third-party service providers are compromised such that this confidential information is disclosed to unauthorized parties, we may be subject to liability. For example, in the event of a security breach, we may incur losses related to fraudulent use of cards issued by us as well as the operational costs associated with reissuing cards. Although we take preventive measures to address these factors, such measures are costly and may become more costly in the future. Moreover, these measures may not protect us from liability, which may not be adequately covered by insurance, or from damage to our reputation.

The financial services and payment services industries are rapidly evolving, and we may be unsuccessful in introducing new products or services on a large scale in response to this evolution.

The financial services and payment services industries experience constant and significant technological changes, such as continuing development of technologies in the areas of smart cards, radio frequency and proximity payment devices, electronic commerce and mobile commerce, among others. The effect of technological changes on our business is unpredictable.

We depend, in part, on third parties for the development of and access to new technologies. We expect that new services and technologies relating to the payments business will continue to appear in the market, and these new services and technologies may be superior to, or render obsolete, the technologies that we currently use in our card products and services. As a result, our future success may be dependent on our ability to identify and adapt to technological changes and evolving industry standards and to provide payment solutions for our customers, merchants and financial institution customers.

Difficulties or delays in the development, production, testing and marketing of new products or services may be caused by a number of factors including, among other things, operational, capital and regulatory constraints. The occurrence of such difficulties may affect the success of our products or services, and developing unsuccessful products and services could result in financial losses, as well as decreased capital availability. In addition, the new products and services offered may not be attractive to our customers and merchant and financial institution customers. Also, success of a new product or service may depend upon our ability to deliver it on a large scale, which may require a significant capital investment that we may not be in a position to make. If we are unable to successfully introduce and maintain new income-generating products and services, it may impact our ability to compete effectively and materially adversely affect our business and earnings.

We rely on technology and on third parties to deliver services. If key technology platforms become obsolete, or if we face difficulties processing transactions or in managing our relationships with third-party service providers, our revenue or results of operations could be materially adversely affected.

We have a large technology staff utilizing current technology. There is no assurance that we will be able to sustain our investment in new technology to avoid obsolescence of critical systems and applications. Further, our transaction authorization and settlement systems, and our clearing system for transactions between Diners Club network licensees, may encounter service interruptions due to system or software failure, fire, natural disasters, power loss, disruptions in long distance or local telecommunications access, terrorism or accident. Some of our transaction processing systems are operated at a single facility and could be subject to service interruptions in the event of failure. Our services could be disrupted by a natural disaster or other problem at any of our primary or back-up facilities or our other owned or leased facilities.

We also depend on third-party service providers for many aspects of the operation of our business. For example, we depend on third parties for the timely transmission of information across our data transportation network and for other telecommunications, processing, remittance and technology related services, including ancillary transaction processing services for the PULSE network and authorization, clearing and settlement services for the Diners Club network. Regardless of whether as a result of natural disaster, operational disruption, terrorism, termination of its relationship with us, or any other reason, if a service provider fails to provide the communications capacity or deliver services that we require or expect, the failure could interrupt our services and operations and hamper our ability to process customers transactions in a timely and accurate manner or to maintain thorough and accurate records of those transactions. Such a failure could adversely affect the perception of the reliability of our networks and services and the quality of our brands, and could materially adversely affect our transaction volumes, our revenues and/or our results of operations.

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

As an issuer and merchant acquirer in the United States on the Discover Network, and as a holder of certain merchant agreements internationally for the Diners Club network, we may be contingently liable for certain disputed credit card sales transactions that arise between customers and merchants. If a dispute is resolved in the customer s favor, we will cause a credit or refund of the amount to be issued to the customer and charge back the transaction to the merchant or merchant acquirer. If we are unable to collect this amount from the merchant or merchant acquirer, we will bear the loss for the amount credited or refunded to the customer. Where the purchased product or service is not provided until some later date following the purchase, such as an airline ticket, the likelihood of potential liability increases. For the years ended November 30, 2010 and 2009, we had $2 million and $6 million, respectively, of losses related to merchant chargebacks.

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

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

Damage to our reputation could damage our business.

Maintaining a positive reputation is critical to our attracting and retaining customers, investors and employees. Damage to our reputation can therefore cause significant harm to our business and prospects. Harm to our reputation can arise from numerous sources, including, among others, employee misconduct, litigation or regulatory outcomes, failing to deliver minimum standards of service and quality, compliance failures, and the activities of customers and counterparties. Negative publicity regarding us, whether or not true, may result in customer attrition and other harm to our business prospects.

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

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

We may not be able to successfully protect our brands and our other intellectual property. If others misappropriate, use or otherwise diminish the value of our intellectual property, our business could be adversely affected. In addition, third

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parties may allege that our marketing, processes or systems may infringe their intellectual property rights. Given the potential risks and uncertainties of such claims, our business could be adversely affected by having to pay significant monetary damages or licensing fees and we may have to alter our business practices.

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

We may consider or undertake strategic acquisitions of, or material investments in, businesses, products, portfolios of loans or technologies, such as our recent acquisition of The Student Loan Corporation. We may not be able to identify suitable acquisition or investment candidates, or even if we do identify suitable candidates, they may be difficult to finance, expensive to fund and there is no guarantee that we can obtain any necessary regulatory approvals or complete the transactions on terms that are favorable to us. To the extent we pay the purchase price of any acquisition or investment in cash, it would reduce our cash balances and regulatory capital, which may have an adverse effect on our financial condition; similarly, if the purchase price is paid with our stock, it would be dilutive to our stockholders. In addition, we may assume liabilities associated with a business acquisition or investment, including unrecorded liabilities that are not discovered at the time of the transaction, and the repayment of those liabilities may have an adverse effect on our financial condition.

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

We are subject to regulation by a number of different regulatory agencies, which have broad discretion to require us to alter our operations in ways that could adversely affect our business or subject us to penalties for noncompliance.

We must comply with an array of banking and consumer lending laws and regulations in all of the jurisdictions in which we operate. As a bank holding company, we are subject to oversight, regulation and examination by the Federal Reserve, including scrutiny of our risk management program; business strategy, earnings, capital and cash flow; anti-money laundering program; and examination of our non-bank businesses, including Discover Network, PULSE and Diners Club, and their relationships with our banking subsidiaries. Our subsidiary, Discover Bank, is subject to regulation and regular examinations by the FDIC and the Delaware Bank Commissioner. In addition, we are subject to regulation by the Federal Trade Commission, state banking regulators and the U.S. Department of Justice, as well as the SEC and New York Stock Exchange in our capacity as a public company. In addition, as our payments business has expanded globally through the acquisition of Diners Club, we are subject to government regulation in countries in which our networks operate or our cards are used, either directly or indirectly through regulation affecting Diners Club network licensees. Beginning in July 2011, we will also be subject to regulation by the Bureau of Consumer Financial Protection.

From time to time, these regulations and regulatory agencies have required us to alter certain of our operating practices, and may require us to do the same in the future. Our ability to execute our business strategies through acquisitions or the introduction of new products or pricing may be impaired or delayed as a result of regulatory review or failure to obtain required regulatory approvals. Various federal and state regulators have broad discretion to impose restrictions and requirements on our company, subsidiaries and operations, including restrictions on capital actions such as increasing dividends. U.S. federal and state consumer protection laws and rules limit the manner and terms on which we may offer and extend credit. We are subject to capital, funding and liquidity requirements prescribed by statutes, regulations and orders, including initiatives under the Reform Act and Basel III that will require us to hold higher levels of capital to support our businesses. We are also subject to the requirements of accounting standard setters and those who interpret the accounting standards (such as the FASB, the SEC, banking regulators and our outside auditors), who may add new requirements or change their interpretations on how standards should be applied, potentially materially impacting how we record and report our financial condition and results of operations. We are also subject to FDIC

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increases in deposit insurance assessments or additional special assessments, which could adversely affect our results of operations and financial condition.

Failure to comply with laws, regulations and other requirements could lead to adverse consequences such as financial, structural, reputational and operational penalties, including receivership, litigation exposure and fines. In addition, efforts to abide by these laws and regulations may increase our costs of operations or limit our ability to execute our business strategies and engage in certain business activities, including affecting our ability to generate or collect receivables from customers.

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

Proposals for legislation further regulating matters affecting public companies are continually being introduced in the U.S. Congress and in state legislatures, including reforms related to health care, employment and particularly the financial services industry. The Reform Act, which was enacted in July 2010, significantly impacts the financial services industry. Among other things, the Reform Act established the Bureau of Consumer Financial Protection to regulate consumer financial services and products, including credit, savings and payment products.

The agencies regulating the financial services industry also periodically adopt changes to their regulations and supervisory guidance and practices. In light of recent conditions in the U.S. financial markets and economy, as well as a heightened regulatory and Congressional focus on consumer lending, regulators have increased their scrutiny of the financial services industry, the result of which has included new regulations and guidance. We are unable to predict the long-term impact of this enhanced scrutiny. We are also unable to predict whether any additional or similar changes to statutes or regulations, including the interpretation or implementation thereof, will occur in the future.

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

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

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

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

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consumer notification in the event of a data breach. In addition, most states have enacted security breach legislation requiring varying levels of consumer notification in the event of certain types of security breaches, and several other states are considering similar legislation.

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

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

Businesses in the credit card industry have historically been subject to significant legal actions, including class action lawsuits and commercial, shareholder and patent litigation. Many of these actions have included claims for substantial compensatory, statutory or punitive damages. While we have historically relied on our arbitration clause in agreements with customers to limit our exposure to consumer class action litigation, there can be no assurance that we will continue to be successful in enforcing our arbitration clause in the future. Legal challenges to the enforceability of these clauses have led most card issuers and may cause us to discontinue their use, and there are bills pending in Congress to directly or indirectly prohibit the use of pre-dispute arbitration clauses. Further, we are involved in pending legal actions challenging our arbitration clause. In addition, we may be involved in various actions or proceedings brought by governmental regulatory agencies in the event of noncompliance with laws or regulations, which could harm our reputation, require us to limit our business activities or subject us to significant fines, penalties or other requirements resulting in increased expenses.

Special Note Regarding Forward-Looking Statements

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

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

- changes in economic variables, such as the availability of consumer credit, the housing market, energy costs, the number and size of personal bankruptcy filings, the rate of unemployment and the levels of consumer confidence and consumer debt, and investor sentiment;
- the impact of current, pending and future legislation, regulation and regulatory and legal actions, including new laws and rules related to financial regulatory reform, new laws and rules limiting or modifying certain credit card practices, new laws and rules affecting securitizations, funding and liquidity, and bank holding company regulations and supervisory guidance;
- the actions and initiatives of current and potential competitors;
- our ability to manage our expenses;
- our ability to successfully achieve card acceptance across our networks and maintain relationships with network participants;

our ability to sustain and grow our private student loan business;

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our ability to manage our credit risk, market risk, liquidity risk, operational risk, legal and compliance risk, and strategic risk;

the availability and cost of funding and capital;

access to deposit, securitization, equity, debt and credit markets;

the impact of rating agency actions;

the level and volatility of equity prices, commodity prices and interest rates, currency values, investments, other market fluctuations and other market indices;

losses in our investment portfolio;

restrictions on our operations resulting from financing transactions;

our ability to increase or sustain Discover card usage or attract new customers;

our ability to attract new merchants and maintain relationships with current merchants;

the effect of political, economic and market conditions, geopolitical events and unforeseen or catastrophic events;

fraudulent activities or material security breaches of key systems;

our ability to introduce new products or services;

our ability to sustain our investment in new technology and manage our relationships with third-party vendors;

our ability to collect amounts for disputed transactions from merchants and merchant acquirers;

our ability to attract and retain employees;

our ability to protect our reputation and our intellectual property;

difficulty financing, transitioning, integrating or managing the expenses of new businesses, products or technologies; and new lawsuits, investigations or similar matters or unanticipated developments related to current matters.

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal properties are located in eight states in the United States. As of January 15, 2011, we owned four principal properties, which included our corporate headquarters, two call centers and a processing center, and we leased five principal properties, which included two call centers, our PULSE headquarters and two Student Loan Corporation offices. The call centers, processing center and Student Loan Corporation offices largely support our Direct Banking segment, the PULSE headquarters is used by our Payment Services segment, and our corporate headquarters is used by both our Direct Banking and Payment Services segments. Both our call centers and processing center are operating at and being utilized to a reasonable capacity and we believe our principal facilities are both suitable and adequate to meet our current and projected needs. We also have seven leased offices, five of which are located outside the United States, that are used to support our Diners Club operations and a leased office that supports our Direct Banking segment.

Item 3. Legal Proceedings

In the normal course of business, from time to time, we have been named as a defendant in various legal actions, including arbitrations, class actions, and other litigation, arising in connection with our activities. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. We have historically relied on the arbitration clause in our cardmember agreements, which has in some instances limited the costs of, and our exposure to, litigation, but there can be no assurance that we will continue to be successful in enforcing our arbitration clause in the future. Legal challenges to the enforceability of these clauses have led most card issuers and may cause us to discontinue their use, and there are bills pending in Congress to directly or indirectly prohibit the use of pre-dispute arbitration clauses. Further, we are involved in pending legal actions challenging our arbitration clause. We are also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental agencies regarding our business, including, among other matters, accounting, tax and operational matters, some of which may result in adverse judgments, settlements, fines, penalties, injunctions, or other relief. For example, we have received a notice of proposed assessment from the IRS related to its audit of our 1999-2005 tax years as further discussed in Note 17: Income Taxes to the consolidated financial statements. Litigation and regulatory actions could also adversely affect our reputation.

We contest liability and/or the amount of damages as appropriate in each pending matter. In view of the inherent difficulty of predicting the outcome of such matters, particularly in cases where claimants seek substantial or indeterminate damages or where investigations and proceedings are in the early stages, we cannot predict with certainty the loss or range of loss, if any, related to such matters, how such matters will be resolved, when they will ultimately be resolved, or what the eventual settlement, fine, penalty or other relief, if any, might be. Subject to the foregoing, we believe, based on current knowledge and after consultation with counsel, that the outcome of the pending matters will not have a material adverse effect on our financial condition, although the outcome of such matters could be material to our operating results and cash flows for a particular future period, depending on, among other things, our level of income for such period.

Bennett et al. v. Discover Card

On November 16, 2010, a putative class action lawsuit was filed against us by a cardmember in the U.S. District Court for the Southern District of California (Michele Bennett et al. v. Discover Card, a/k/a DFS Services LLC). The plaintiff alleges that we contacted her, and members of the putative class, on their cellular telephones without their express consent in violation of the Telephone Consumer Protection Act (TCPA). The TCPA provides for statutory damages of $500 for each violation ($1,500 for willful violations). Plaintiff seeks statutory damages for alleged negligent and willful violations of the TCPA, attorneys fees, costs and injunctive relief. We will seek to vigorously defend all claims asserted against us. We are not in a position at this time to assess the likely outcome or our exposure, if any, with respect to this matter.

Payment Protection Cases

On December 6, 2010, the Attorney General for the State of Minnesota filed a lawsuit against us in the District Court for Hennepin County, Minnesota (Minnesota v. Discover Financial Services, Discover Bank and DFS Services, LLC). The lawsuit challenges our enrollment of Discover cardmembers in our various fee based products under Minnesota law. The remedies sought in the lawsuit include an injunction prohibiting us from engaging in the alleged violations, restitution for all persons allegedly injured by the complained of practices, civil penalties and costs. We will seek to vigorously defend all claims asserted against us. We are not in a position at this time to assess the likely outcome or our exposure, if any, with respect to this matter.

As of January 15, 2011, there were six putative class action cases pending in relation to the sale of our payment protection fee product. The cases were filed (all in United States District Courts) on July 8, 2010 in the Northern District of California (Walker, et al. v. DFS, Inc. and Discover Bank; subsequently transferred to the Northern District of Illinois); July 16, 2010 in the Central District of California (Conroy v. Discover Financial Services and Discover Bank); October 22, 2010 in the District of South Carolina (Alexander v. Discover Financial Services, Inc.; DFS Services, LLC; Discover Bank; and Morgan Stanley); November 5, 2010 in the Northern District of Illinois (Callahan v. Discover Financial Services, Inc. and Discover Bank); December 17, 2010 in the Western District of Tennessee (Sack v. DFS Services, LLC; Discover

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Financial Services, Inc.; and Discover Bank); and January 14, 2011 in the Eastern District of Pennsylvania (Boyce v. DFS Services LLC; Discover Financial Services Inc.; Discover Bank). Each of these lawsuits challenges our marketing practices with respect to our payment protection fee product to our cardmembers under various state laws and the Truth in Lending Act. The plaintiffs seek monetary remedies including unspecified damages and restitution, attorneys fees and costs, and various forms of injunctive relief including an order rescinding the payment protection fee product enrollments of all class members. We will seek to vigorously defend all claims asserted against us. We are not in a position at this time to assess the likely outcomes or our exposure, if any, with respect to these matters.

Item 4. (Removed and Reserved).

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

Common Stock Market Prices and Dividends

Our common stock began trading regular way on the NYSE (ticker symbol DFS) on July 2, 2007. The approximate number of record holders of our common stock at January 15, 2011 was 86,021.

The following table sets forth the quarterly high and low sales prices as reported by the NYSE and the dividends declared by us during the quarter indicated:

Quarter Ended:			**Cash Dividends**
2009	**Stock Price**		**Declared**
February 28	$ 11.47	$ 5.05	$ 0.06
May 31	$ 11.65	$ 4.73	$ 0.02
August 31	$ 14.24	$ 8.58	$ 0.02
November 30	$ 17.36	$ 12.87	$ 0.02
2010			
February 28	$ 16.78	$ 12.58	$ 0.02
May 31	$ 16.59	$ 12.61	$ 0.02
August 31	$ 15.78	$ 12.11	$ 0.02
November 30	$ 19.16	$ 14.65	$ 0.02

During our second quarter of 2009, we reduced our quarterly common stock dividend from $.06 per share to $.02 per share and we have maintained a $.02 per share dividend since that time. We expect to continue our policy of paying regular cash dividends, although there is no assurance as to future dividends because they are subject to board approval and depend on future earnings, capital requirements and financial condition. In addition, our banking regulators and applicable banking laws and regulations may limit our ability to pay dividends. Further, as a result of provisions that may be contained in our borrowing agreements or the borrowing agreements of our subsidiaries, our ability to pay dividends to our stockholders may be limited.

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Issuer Purchases of Equity Securities

The table below sets forth the information with respect to purchases of our common stock made by us or on our behalf during the fourth quarter of our year ended November 30, 2010:

Period	Total Number of Shares Purchased[(2)]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[(1)]	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
September 1 30, 2010				
Repurchase program[(1)]		$		$ 1 billion
Employee transactions[(2)]	2,687	$ 15.22	N/A	N/A
October 1 31, 2010				
Repurchase program[(1)]		$		$ 1 billion
Employee transactions[(2)]	2,970	$ 16.58	N/A	N/A
November 1 30, 2010				
Repurchase program[(1)]		$		$ 1 billion
Employee transactions[(2)]	301	$ 18.14	N/A	N/A
Total				
Repurchase program[(1)]		$		$ 1 billion
Employee transactions[(2)]	5,958	$ 16.05	N/A	N/A

(1) On December 3, 2007, we announced that our board of directors authorized the repurchase of up to $1 billion of our outstanding stock under a new share repurchase program. This share repurchase program expired on November 30, 2010. At November 30, 2010, we had not repurchased any stock under this program.

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

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Stock Performance Graph

The following graph compares the cumulative total stockholder return (rounded to the nearest whole dollar) of our common stock, the S&P 500 Stock Index and the S&P 500 Financials Index for the period from July 2, 2007 through November 30, 2010. The graph assumes an initial investment of $100 on July 2, 2007, the date we began regular way trading on the NYSE following our spin-off. The cumulative returns include stock price appreciation and assume full reinvestment of dividends. This graph does not forecast future performance of our common stock.

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

Item 6. Selected Financial Data

The following table presents our selected financial data and operating statistics. The statement of income data for each of the years in the three-year period ended November 30, 2010 and the statement of financial condition data as of November 30, 2010 and 2009 have been derived from our audited consolidated financial statements included elsewhere in this annual report on Form 10-K. The statement of financial condition data as of November 30, 2008 and 2007, and the statement of income data for the year ended November 30, 2007 have been derived from audited consolidated financial statements not included elsewhere in this annual report on Form 10-K.

The selected financial data as of and for the year ended November 30, 2006, is for a period prior to our spin-off from Morgan Stanley, and has been derived from unaudited combined financial statements. The combined basis presentation reflects the historical combined income and financial condition of the Morgan Stanley subsidiaries that comprised its Discover segment. Prior to our spin-off, the Discover segment consisted of Discover Financial Services, a wholly-owned subsidiary of Morgan Stanley, and certain other subsidiaries and assets related to credit card operations in the United Kingdom, which are now presented as discontinued operations, that were contributed to the Discover segment by Morgan Stanley in conjunction with the spin-off. The combined selected financial data presented for 2006 does not reflect any changes that have occurred in our financing and operations as a result of our spin-off and accordingly, may not be indicative of our future performance or of the results that would have been achieved had we operated as a separate, stand-alone entity during that period. However, the combined financial data presented for 2006 has been prepared on the same basis as the audited financial statements and, in the opinion of our management, include all adjustments, consisting of only ordinary recurring adjustments, necessary for a fair presentation of the information set forth in this annual report on Form 10-K.

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

Discover Financial Services

Selected Financial Data

	For the Years Ended November 30,				
	2010[1]	2009	2008	2007	2006
	(dollars in thousands, except per share amounts)				
Statement of Income Data:					
Interest income	$ 6,146,218	$ 3,145,080	$ 2,692,563	$ 2,584,402	$ 2,209,192
Interest expense	1,582,988	1,251,284	1,288,004	1,223,270	836,280
Net interest income	4,563,230	1,893,796	1,404,559	1,361,132	1,372,912
Other income[2]	2,094,999	4,840,595	4,264,458	3,376,682	3,368,664
Revenue net of interest expense	6,658,229	6,734,391	5,669,017	4,737,814	4,741,576
Provision for loan losses	3,206,705	2,362,405	1,595,615	733,887	606,765
Other expense	2,182,665	2,251,088	2,415,797	2,478,214	2,467,058
Income before income tax expense	1,268,859	2,120,898	1,657,605	1,525,713	1,667,753
Income tax expense	504,071	844,713	594,692	561,514	535,563
Income from continuing operations	764,788	1,276,185	1,062,913	964,199	1,132,190
Loss from discontinued operations, net of tax[3]			(135,163)	(375,569)	(55,574)
Net income[2]	$ 764,788	$ 1,276,185	$ 927,750	$ 588,630	$ 1,076,616
Net income allocated to common stockholders	$ 667,938	$ 1,206,965	$ 910,510	$ 572,480	$ 1,076,616
Statement of Financial Condition Data (as of):					
Loan receivables	$ 48,836,413	$ 23,625,084	$ 25,216,611	$ 20,831,117	$ 20,790,244
Total assets	$ 60,784,968	$ 46,020,987	$ 39,892,382	$ 37,376,105	$ 29,064,898
Total stockholders equity	$ 6,456,846	$ 8,435,547	$ 5,915,823	$ 5,599,422	$ 5,774,772
Allowance for loan losses	$ 3,304,118	$ 1,757,899	$ 1,374,585	$ 759,925	$ 703,917
Long-term borrowings	$ 17,705,728	$ 2,428,101	$ 1,735,383	$ 2,134,093	$ 819,496
Per Share of Common Stock:					
Basic EPS from continuing operations	$ 1.23	$ 2.39	$ 2.18	$ 1.99	$ 2.37
Diluted EPS from continuing operations	$ 1.22	$ 2.38	$ 2.18	$ 1.98	$ 2.37
Weighted average shares outstanding (000 s)[4]	544,058	504,540	479,335	477,328	477,236
Weighted average shares outstanding (fully diluted) (000 s)[4]	548,760	507,907	479,357	477,988	477,236
Cash dividends declared	$ 0.08	$ 0.12	$ 0.24	$ 0.06	
Dividend payout ratio	6.52%	5.02%	11.01%	3.02%	
Ratios:					
Return on average equity	12%	17%	16%	10%	20%
Return on average assets	1%	3%	3%	2%	4%
Average stockholders equity to average total assets	11%	18%	15%	15%	17%

(1)

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

(2) The years ended November 30, 2009 and 2008 include $1.9 billion pretax ($1.2 billion after tax) and $0.9 billion pretax ($0.5 billion after tax), respectively, of income related to the Visa and MasterCard antitrust litigation settlement, which is included in our Direct Banking segment. See Note 21: Litigation to the consolidated financial statements.

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

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

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

	For the Years Ended November 30,				
	2010	2009(1)	2008(1)	2007(1)	2006(1)
	(dollars in thousands)				
Selected Statistics:					
Total Loan Receivables					
GAAP information:					
Loan receivables	$ 48,836,413	$ 23,625,084	$ 25,216,611	$ 20,831,117	$ 20,790,244
Average loan receivables	$ 49,909,187	$ 26,552,574	$ 21,348,493	$ 19,947,784	$ 19,252,929
Interest yield	12.20%	11.31%	10.89%	10.73%	10.48%
Net principal charge-off rate	7.57%	7.45%	4.59%	3.40%	3.63%
Delinquency rate (over 30 days)	3.89%	4.92%	4.35%	3.26%	3.05%
Delinquency rate (over 90 days)	2.04%	2.58%	2.06%	1.51%	1.43%
As adjusted information:					
Loan receivables As adjusted	N/A	$ 50,854,146	$ 51,095,278	$ 48,180,436	$ 45,802,071
Average loan receivables As adjusted	N/A	$ 51,130,117	$ 49,011,148	$ 46,913,474	$ 44,409,232
Interest yield As adjusted	N/A	12.40%	12.59%	12.65%	12.52%
Net principal charge-off rate As adjusted	N/A	7.77%	5.01%	3.83%	3.95%
Delinquency rate (over 30 days) As adjusted	N/A	5.31%	4.56%	3.58%	3.39%
Delinquency rate (over 90 days) As adjusted	N/A	2.78%	2.17%	1.67%	1.59%
Total Credit Card Loan Receivables					
GAAP information					
Credit card loan receivables	$ 45,156,994	$ 20,230,302	$ 23,814,307	$ 20,579,923	$ 20,694,395
Average credit card loan receivables	$ 45,616,791	$ 24,266,782	$ 20,566,864	$ 19,845,880	$ 19,120,946
Interest yield	12.79%	11.69%	10.92%	10.75%	10.50%
Net principal charge-off rate	8.08%	7.87%	4.73%	3.41%	3.64%
Delinquency rate (over 30 days)	4.06%	5.52%	4.55%	3.28%	3.05%
Delinquency rate (over 90 days)	2.12%	2.92%	2.16%	1.53%	1.44%
As adjusted information:					
Credit card loan receivables As adjusted	N/A	$ 47,459,364	$ 49,692,974	$ 47,929,242	$ 45,706,222
Average credit card loan receivables As adjusted	N/A	$ 48,844,325	$ 48,229,519	$ 46,811,570	$ 44,277,249
Interest yield As adjusted	N/A	12.63%	12.63%	12.66%	12.53%
Net principal charge-off rate As adjusted	N/A	8.00%	5.07%	3.84%	3.96%
Delinquency rate (over 30 days) As adjusted	N/A	5.60%	4.66%	3.59%	3.39%
Delinquency rate (over 90 days) As adjusted	N/A	2.94%	2.22%	1.68%	1.59%

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

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

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

Unless otherwise specified, references to Notes to our consolidated financial statements are to the Notes to our audited consolidated financial statements as of November 30, 2010 and 2009 and for the three-year period ended November 30, 2010.

Introduction and Overview

Discover Financial Services is a direct banking and payment services company. We are a bank holding company under the Bank Holding Company Act of 1956, subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve). We are also a financial holding company under the Gramm-Leach-Bliley Act. Through our Discover Bank subsidiary, we offer our customers credit cards, student loans, personal loans and deposit products. Through our DFS Services LLC subsidiary and its subsidiaries, we operate the Discover Network, the PULSE network (PULSE) and Diners Club International (Diners Club). The Discover Network provides credit card transaction processing for Discover card-branded and third-party issued credit cards. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE network with access to ATMs domestically and internationally, as well as point of sale terminals at retail locations throughout the U.S. for debit card transactions. Diners Club is a global payments network that grants rights to licensees, which are generally financial institutions, to issue Diners Club branded credit cards and/or to provide card acceptance services. Our Diners Club business also offers transaction processing and marketing services to licensees globally. Our fiscal year ends on November 30 of each year.

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

Change in Accounting Principle Related to Off-Balance Sheet Securitizations

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

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

Consolidation of $22.3 billion of securitized loan receivables and the related debt issued from the trusts to third-party investors;

- Reclassification of $4.6 billion of certificated retained interests classified as investment securities to loan receivables;

- Recording of a $2.1 billion allowance for loan losses, not previously required under GAAP, for the newly consolidated and reclassified credit card loan receivables;

- Derecognition of the remaining $0.1 billion value of the interest-only strip receivable, net of tax, recorded in amounts due from asset securitization and reclassification of the remaining $1.6 billion of amounts due from asset securitization to restricted cash, loan receivables and other assets; and

- Recording of net deferred tax assets of $0.8 billion, largely related to establishing an allowance for loan losses on the newly consolidated and reclassified credit card loan receivables.

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

Reconciliations of GAAP to As Adjusted Data

We did not retrospectively adopt Statements No. 166 and 167 and, therefore, the consolidated financial statements presented in this annual report as of and for the year ended November 30, 2010 reflect the new accounting requirements, but the historical statement of financial condition as of November 30, 2009 and statements of income and statements of cash flows for the years ended November 30, 2009 and 2008 continue to reflect the accounting applicable prior to the adoption of the new accounting requirements.

To enable the reader to better understand our financial information by reflecting period-over-period data on a consistent basis, this Management s Discussion and Analysis of Financial Condition and Results of Operations presents our financial information as of and for the year ended November 30, 2010 as compared to adjusted results of operations data for the years ended November 30, 2009 and 2008, and, where necessary, we have also provided certain information as of and for the year ended November 30, 2007 and 2006 on an as adjusted basis. Management believes the adjusted financial information is useful to investors as it aligns with the financial information used in its decision-making process and in evaluating the business. The as adjusted amounts:

- show how our financial data would have been presented if the trusts used in our securitization activities were consolidated into our financial statements for such historical periods;

- remove the impact of income received in connection with the settlement of our antitrust litigation with Visa and MasterCard during the years ended November 30, 2009 and 2008; and

- exclude the interest charge related to our dispute with Morgan Stanley regarding the special dividend agreement, which, among other things, specified how proceeds of the antitrust litigation with Visa and MasterCard were to be shared.

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

Then, additional adjustments were made to reflect results as if the trusts used in our securitization activities had been fully consolidated in our historical results. These adjustments include:

- Elimination of interest income and interest expense related to certificated retained interests classified as investment securities and associated intercompany debt;
- An adjustment to the provision for loan losses for the change in securitized loan receivables;
- Elimination of the revaluation gains or losses associated with the interest-only strip receivable, which was derecognized upon adoption; and
- An adjustment to reflect the income tax effects related to these adjustments.

The impacts of Statements No. 166 and 167 on our effective tax rate, loan receivables and average balance sheet information and certain other selected financial data are reflected in one step, rather than two, in the reconciliations of GAAP to as adjusted data set forth in the tables below as there is no meaningful difference between such information on a historical managed basis as compared to on an as adjusted basis.

Earnings Summary and Reconciliation

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

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	For the Year Ended November 30, 2008				
	As Reported	Securitization Adjustments	Managed	Additional Adjustments	As Adjusted
	(dollars in thousands)				
Interest income	$ 2,692,563	$ 3,853,266	$ 6,545,829	$ (54,760)(A)	$ 6,491,069
Interest expense	1,288,004	1,068,915	2,356,919	(45,595)(B)	2,311,324
Net interest income	1,404,559	2,784,351	4,188,910	(9,165)	4,179,745
Provision for loan losses	1,595,615	1,472,989	3,068,604	408,040(C)	3,476,644
Net interest income after provision for loan losses	(191,056)	1,311,362	1,120,306	(417,205)	703,101
Antitrust litigation settlement	863,634		863,634	(863,634)(D)	
Other income	3,400,824	(1,311,362)	2,089,462	104,322(E)	2,193,784
Total other income	4,264,458	(1,311,362)	2,953,096	(759,312)	2,193,784
Total other expense	2,415,797		2,415,797		2,415,797
Income (loss) before income tax expense	1,657,605		1,657,605	(1,176,517)	481,088
Income tax expense (benefit)	594,692		594,692	(444,530)(G)	150,162
Income (loss) from continuing operations	$ 1,062,913	$	$ 1,062,913	$ (731,987)	$ 330,926

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

Other Income and Reconciliation

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

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	For the Year Ended November 30, 2008				
	As Reported	Securitization Adjustments	Managed	Additional Adjustments	As Adjusted
	(dollars in thousands)				
Securitization income	$ 2,429,158	$ (2,429,158)	$	$	$
Discount and interchange revenue	187,657	781,903	969,560		969,560
Fee products	249,805	111,612	361,417		361,417
Loan fee income	262,576	343,605	606,181	(15,002)	591,179
Transaction processing revenue	115,914		115,914		115,914
Merchant fees	67,027		67,027		67,027
Loss on investment securities	(50,294)		(50,294)		(50,294)
Antitrust litigation settlement	863,634		863,634	(863,634)(A)	
Other income	138,981	(119,324)	19,657	119,324(B)	138,981
Total other income	$ 4,264,458	$ (1,311,362)	$ 2,953,096	$ (759,312)	$ 2,193,784

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

Direct Banking Segment Summary and Reconciliation

	For the Year Ended November 30, 2009				
	As Reported	Securitization Adjustments	Managed	Additional Adjustments	As Adjusted
	(dollars in thousands)				
Interest income	$ 3,143,982	$ 3,315,992	$ 6,459,974	$ (25,920)(A)	$ 6,434,054
Interest expense	1,251,062	397,136	1,648,198	(42,921) (B)	1,605,277
Net interest income	1,892,920	2,918,856	4,811,776	17,001	4,828,777
Provision for loan losses	2,362,405	1,995,936	4,358,341	764,689 (C)	5,123,030
Other income	4,600,801	(922,920)	3,677,881	(1,731,611)(D)	1,946,270
Other expense	2,116,962		2,116,962	(28,992)(E)	2,087,970
Income (loss) before income tax expense	$ 2,014,354	$	$ 2,014,354	$ (2,450,307)(F)	$ (435,953)

	For the Year Ended November 30, 2008				
	As Reported	Securitization Adjustments	Managed	Additional Adjustments	As Adjusted
	(dollars in thousands)				
Interest income	$ 2,689,398	$ 3,853,266	$ 6,542,664	$ (54,760)(A)	$ 6,487,904
Interest expense	1,287,921	1,068,915	2,356,836	(45,595)(B)	2,311,241
Net interest income	1,401,477	2,784,351	4,185,828	(9,165)	4,176,663
Provision for loan losses	1,595,615	1,472,989	3,068,604	408,040 (C)	3,476,644
Other income	4,085,258	(1,311,362)	2,773,896	(759,312)(D)	2,014,584
Other expense	2,314,926		2,314,926		2,314,926
Income (loss) from continuing operation before income tax expense	$ 1,576,194	$	$ 1,576,194	$ (1,176,517)(F)	$ 399,677

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

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Loan Receivables Data and Reconciliation

	As of and for the Year Ended November 30,			
Total Loan Receivables	**2009**	**2008**	**2007**	**2006**
	(dollars in thousands)			
Loan portfolio				
GAAP	$ 23,625,084	$ 25,216,611	$ 20,831,117	$ 19,733,864
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319	26,064,459
As Adjusted	$ 50,854,146	$ 51,095,278	$ 48,180,436	$ 45,798,323
Loan receivables				
GAAP	$ 23,625,084	$ 25,216,611	$ 20,831,117	$ 20,790,244
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319	25,011,827
As Adjusted	$ 50,854,146	$ 51,095,278	$ 48,180,436	$ 45,802,071
Allowance for loan losses (beginning of period)				
GAAP	$ 1,374,585	$ 759,925	$ 703,917	$ 795,722
Adjustments for Statement No. 167	1,379,772	971,730	928,374	1,153,101
As Adjusted	$ 2,754,357	$ 1,731,655	$ 1,632,291	$ 1,948,823
Provision for loan losses				
GAAP	$ 2,362,405	$ 1,595,615	$ 733,887	$ 606,765
Adjustments for Statement No. 167	2,760,625	1,881,029	1,162,866	831,981
As Adjusted	$ 5,123,030	$ 3,476,644	$ 1,896,753	$ 1,438,746
Charge-offs				
GAAP	$ (2,165,653)	$ (1,147,241)	$ (839,092)	$ (852,636)
Adjustments for Statement No. 167	(2,208,036)	(1,713,409)	(1,366,949)	(1,331,501)
As Adjusted	$ (4,373,689)	$ (2,860,650)	$ (2,206,041)	$ (2,184,137)
Recoveries				
GAAP	$ 186,562	$ 166,286	$ 161,213	$ 154,066
Adjustments for Statement No. 167	212,100	240,422	247,439	274,793
As Adjusted	$ 398,662	$ 406,708	$ 408,652	$ 428,859
Net charge-offs				
GAAP	$ (1,979,091)	$ (980,955)	$ (677,879)	$ (698,570)
Adjustments for Statement No. 167	(1,995,936)	(1,472,987)	(1,119,510)	(1,056,708)
As Adjusted	$ (3,975,027)	$ (2,453,942)	$ (1,797,389)	$ (1,755,278)
Allowance for loan losses (end of period)				
GAAP	$ 1,757,899	$ 1,374,585	$ 759,925	$ 703,917
Adjustments for Statement No. 167	2,144,461	1,379,772	971,730	928,374
As Adjusted	$ 3,902,360	$ 2,754,357	$ 1,731,655	$ 1,632,291
Reserve Rate (end of period) %				
GAAP	7.44%	5.45%	3.65%	3.39%
Adjustments for Statement No. 167	0.23	(0.06)	(0.06)	0.09

As Adjusted	7.67%	5.39%	3.59%	3.48%
Net charge-offs %				
GAAP	7.45%	4.59%	3.40%	3.63%
Adjustments for Statement No. 167	0.32	0.42	0.43	0.32
As Adjusted	7.77%	5.01%	3.83%	3.95%
Delinquencies (Over 30 Days)				
GAAP	$ 1,161,497	$ 1,096,627	$ 679,306	$ 633,150
Adjustments for Statement No. 167	1,539,462	1,233,581	1,044,014	918,887
As Adjusted	$ 2,700,959	$ 2,330,208	$ 1,723,320	$ 1,552,037

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Total Loan Receivables	2009	2008	2007	2006
	As of and for the Year Ended November 30, (dollars in thousands)			
Delinquencies (Over 90 Days and accruing interest)				
GAAP	$ 522,190	$ 444,324	$ 271,227	$ 244,675
Adjustments for Statement No. 167	694,864	508,241	424,075	360,118
As Adjusted	$ 1,217,054	$ 952,565	$ 695,302	$ 604,793
Loans not accruing interest				
GAAP	$ 190,086	$ 173,123	$ 102,286	$ 110,625
Adjustments for Statement No. 167	248,192	193,385	154,408	151,152
As Adjusted	$ 438,278	$ 366,508	$ 256,694	$ 261,777
Delinquency rate (Over 30 Days)				
GAAP	4.92%	4.35%	3.26%	3.05%
Adjustments for Statement No. 167	0.39	0.21	0.32	0.34
As Adjusted	5.31%	4.56%	3.58%	3.39%
Delinquency rate (Over 90 Days)				
GAAP	2.58%	2.06%	1.51%	1.43%
Adjustments for Statement No. 167	0.20	0.11	0.16	0.16
As Adjusted	2.78%	2.17%	1.67%	1.59%
Delinquency rate (Over 90 Days and accruing interest)				
GAAP	2.21%	1.76%	1.30%	1.18%
Adjustments for Statement No. 167	0.18	0.10	0.14	0.11
As Adjusted	2.39%	1.86%	1.44%	1.29%
Delinquency rate (Loans not accruing interest)				
GAAP	0.80%	0.69%	0.49%	0.53%
Adjustments for Statement No. 167	0.06	0.03	0.04	0.04
As Adjusted	0.86%	0.72%	0.53%	0.57%
Discover Card				
Charge-offs				
GAAP	$ (2,034,458)	$ (1,119,362)	$ (834,792)	$ (848,645)
Adjustments for Statement No. 167	(2,208,036)	(1,713,409)	(1,366,949)	(1,331,501)
As Adjusted	$ (4,242,494)	$ (2,832,771)	$ (2,201,741)	$ (2,180,146)
Recoveries				
GAAP	$ 184,383	$ 165,422	$ 160,167	$ 153,006
Adjustments for Statement No. 167	212,100	240,422	247,439	274,793
As Adjusted	$ 396,483	$ 405,844	$ 407,606	$ 427,799
Total Discover Card Loans				
GAAP	$ 19,826,153	$ 23,348,134	$ 20,345,787	$ 19,582,675
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319	26,064,459
As Adjusted	$ 47,055,215	$ 49,226,801	$ 47,695,106	$ 45,647,134
Allowance for loan losses (end of period)				

GAAP	$ 1,587,107	$ 1,285,215	$ 742,507	$ 698,945
Adjustments for Statement No. 167	2,144,461	1,379,771	971,730	928,375
As Adjusted	$ 3,731,568	$ 2,664,986	$ 1,714,237	$ 1,627,320
Total Credit Card Loans				
Loan receivables				
GAAP	$ 20,230,302	$ 23,814,307	$ 20,579,923	$ 20,694,395
Adjustments for Statement No. 167	27,229,062	25,878,667	27,349,319	25,011,827
As Adjusted	$ 47,459,364	$ 49,692,974	$ 47,929,242	$ 45,706,222

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Total Credit Card Loans	2009	2008	2007	2006
	As of and for the Year Ended November 30, (dollars in thousands)			
Charge-offs				
GAAP	$ (2,096,573)	$ (1,139,176)	$ (837,210)	$ (848,645)
Adjustments for Statement No. 167	(2,208,036)	(1,713,409)	(1,366,949)	(1,331,501)
As Adjusted	$ (4,304,609)	$ (2,852,585)	$ (2,204,159)	$ (2,180,146)
Recoveries				
GAAP	$ 185,616	$ 165,694	$ 160,202	$ 153,006
Adjustments for Statement No. 167	212,100	240,422	247,439	274,793
As Adjusted	$ 397,716	$ 406,116	$ 407,641	$ 427,799
Net charge-offs				
GAAP	$ (1,910,957)	$ (973,482)	$ (677,008)	$ (695,639)
Adjustments for Statement No. 167	(1,995,936)	(1,472,987)	(1,119,510)	(1,056,708)
As Adjusted	$ (3,906,893)	$ (2,446,469)	$ (1,796,518)	$ (1,752,347)
Allowance for loan losses (end of period)				
GAAP	$ 1,647,086	$ 1,317,811	$ 750,786	$ 701,162
Adjustments for Statement No. 167	2,144,461	1,379,772	971,730	928,374
As Adjusted	$ 3,791,547	$ 2,697,583	$ 1,722,516	$ 1,629,536
Net charge-offs %				
GAAP	7.87%	4.73%	3.41%	3.64%
Adjustments for Statement No. 167	0.13	0.34	0.43	0.32
As Adjusted	8.00%	5.07%	3.84%	3.96%
Delinquency Rate (over 30 days)				
GAAP	5.52%	4.55%	3.28%	3.05%
Adjustments for Statement No. 167	0.08	0.11	0.31	0.34
As Adjusted	5.60%	4.66%	3.59%	3.39%
Delinquency Rate (over 90 days)				
GAAP	2.92%	2.16%	1.53%	1.44%
Adjustments for Statement No. 167	0.02	0.06	0.15	0.15
As Adjusted	2.94%	2.22%	1.68%	1.59%

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Average Balance Sheet Reconciliation

	For the Year Ended November 30, 2009			For the Year Ended November 30, 2008		
	Average Balances	Interest Income/Expense	Yield	Average Balances	Interest Income/Expense	Yield
	(dollars in thousands)			(dollars in thousands)		
Average restricted cash						
GAAP	$	$	%	$	$	%
Adjustments for Statement No. 167	2,438,438	18,195	0.75	2,770,260	95,060	3.43
As Adjusted	$ 2,438,438	$ 18,195	0.75%	$ 2,770,260	$ 95,060	3.43%
Average investment securities						
GAAP	$ 1,581,387	$ 68,694	4.34%	$ 916,307	$ 51,345	5.60%
Adjustments for Statement No. 167	(1,096,270)	(43,464)	0.86	(721,633)	(45,993)	(2.85)
As Adjusted	$ 485,117	$ 25,230	5.20%	$ 194,674	$ 5,352	2.75%
Average credit card loan receivables						
GAAP	$ 24,266,782	$ 2,835,767	11.69%	$ 20,566,864	$ 2,245,719	10.92%
Adjustments for Statement No. 167	24,577,543	3,333,536	0.94	27,662,655	3,844,499	1.71
As Adjusted	$ 48,844,325	$ 6,169,303	12.63%	$ 48,229,519	$ 6,090,218	12.63%
Average total loan receivables						
GAAP	$ 26,552,574	$ 3,004,284	11.31%	$ 21,348,493	$ 2,325,414	10.89%
Adjustments for Statement No. 167	24,577,543	3,333,536	1.09	27,662,655	3,844,499	1.70
As Adjusted	$ 51,130,117	$ 6,337,820	12.40%	$ 49,011,148	$ 6,169,913	12.59%
Average other interest-earning assets						
GAAP	$ 2,338,438	$ 18,195	0.78%	$ 2,770,260	$ 95,060	3.43%
Adjustments for Statement No. 167	(2,338,438)	(18,195)	(0.78)	(2,770,260)	(95,060)	(3.43)
As Adjusted	$	$	%	$	$	%
Average total interest-earning assets						
GAAP	$ 39,989,758	$ 3,145,080	7.86%	$ 33,409,965	$ 2,692,563	8.06%
Adjustments for Statement No. 167	23,581,273	3,290,072	2.26	26,941,022	3,798,506	2.70
As Adjusted	$ 63,571,031	$ 6,435,152	10.12%	$ 60,350,987	$ 6,491,069	10.76%
Average allowance for loan losses						
GAAP	$ (1,808,493)			$ (887,668)		
Adjustments for Statement No. 167	(1,741,736)			(1,145,671)		
As Adjusted	$ (3,550,229)			$ (2,033,339)		
Average other assets (non-interest bearing)						
GAAP	$ 4,053,270			$ 2,960,496		
Adjustments for Statement No. 167	(913,561)			(438,618)		
As Adjusted	$ 3,139,709			$ 2,521,878		
Average total assets						
GAAP	$ 42,234,535			$ 36,804,388		

Adjustments for Statement No. 167	20,925,976			25,356,733		
As Adjusted	$ 63,160,511			$ 62,161,121		
Average securitized borrowings						
GAAP	$	$	%	$	$	%
Adjustments for Statement No. 167	22,720,700	354,215	1.56	26,897,712	1,023,320	3.80
As Adjusted	$ 22,720,700	$ 354,215	1.56%	$ 26,897,712	$ 1,023,320	3.80%
Average total borrowings						
GAAP	$ 2,486,187	$ 64,200	2.58%	$ 1,956,807	$ 88,568	4.53%
Adjustments for Statement No. 167	22,720,700	354,215	(0.92)	26,897,712	1,023,320	(0.69)
As Adjusted	$ 25,206,887	$ 418,415	1.66%	$ 28,854,519	$ 1,111,888	3.84%
Average total interest-bearing liabilities						
GAAP	$ 31,609,777	$ 1,251,284	3.96%	$ 27,644,581	$ 1,288,005	4.66%
Adjustments for Statement No. 167	22,720,700	354,215	(1.00)	26,897,712	1,023,320	(0.42)
As Adjusted	$ 54,330,477	$ 1,605,499	2.96%	$ 54,542,293	$ 2,311,325	4.24%

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	For the Year Ended November 30, 2009	For the Year Ended November 30, 2008
	Average Balances (dollars in thousands, except where noted)	
Average other liabilities and stockholders equity (non-interest earning)		
GAAP	$ 10,624,758	$ 9,159,807
Adjustments for Statement No. 167	(1,794,724)	(2,609,385)
As Adjusted	$ 8,830,034	$ 6,550,422
Average total liabilities and stockholders equity		
GAAP	$ 42,234,535	$ 36,804,388
Adjustments for Statement No. 167	20,925,976	25,356,733
As Adjusted	$ 63,160,511	$ 62,161,121
	Ratios and Other Amounts	
Net interest margin		
GAAP	7.13%	6.58%
Adjustments for Statement No. 167	2.32	1.95
As Adjusted	9.45%	8.53%
Net yield on interest-earning assets		
GAAP	4.74%	4.20%
Adjustments for Statement No. 167	2.86	2.73
As Adjusted	7.60%	6.93%
Interest rate spread		
GAAP	3.90%	3.40%
Adjustments for Statement No. 167	3.26	3.13
As Adjusted	7.16%	6.53%
Amortization of balance transfer fees in interest income on credit card loans (dollars in millions)		
GAAP	$ 128	$ 70
Adjustments for Statement No. 167	59	45
As Adjusted	$ 187	$ 115

	For the Year Ended November 30, 2007	For the Year Ended November 30, 2006
Total average loan receivables		
GAAP	$ 19,947,784	$ 19,252,929
Adjustments for Statement No. 167	26,965,690	25,156,303

As Adjusted	$ 46,913,474	$ 44,409,232
Total loans interest yield		
GAAP	10.73%	10.48%
Adjustments for Statement No. 167	1.91	2.03
As Adjusted	12.64%	12.51%
Total average credit card loan receivables		
GAAP	$ 19,845,880	$ 19,120,946
Adjustments for Statement No. 167	26,965,690	25,156,303
As Adjusted	$ 46,811,570	$ 44,277,249
Credit card interest yield		
GAAP	10.75%	10.50%
Adjustments for Statement No. 167	1.91	2.03
As Adjusted	12.66%	12.53%

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2010 Highlights

Net income in 2010 was $765 million as compared to a reported net income of $1.3 billion in 2009 (which included $1.2 billion of after tax income from the settlement of our antitrust litigation) and an as adjusted net loss of $237 million in 2009.

After peaking in the first quarter, net charge-offs declined throughout the remainder of 2010. Our over 30 day delinquencies declined throughout 2010 after peaking in the fourth quarter of 2009. At November 30, 2010, the twelve-month outlook for credit had improved in comparison to the outlook at the end of 2009 resulting in a decline in the loan loss reserve rate, which led to a $598 million reduction of our allowance for loan losses in 2010.