Discover Financial Services
Form 10-Q
October 04, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended August 31, 2012

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 001-33378
DISCOVER FINANCIAL SERVICES
(Exact name of registrant as specified in its charter)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes S No ¨

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

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

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

As of September 28, 2012, there were 504,775,854 shares of the registrant’s Common Stock, par value $0.01 per share, outstanding.

DISCOVER FINANCIAL SERVICES
Quarterly Report on Form 10-Q
for the quarterly period ended August 31, 2012
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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 quarterly report on Form 10-Q are the property of their respective owners.

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements
DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Financial Condition

	August 31, 2012 (unaudited)	November 30, 2011
	(dollars in thousands, except share amounts)	
Assets		
Cash and cash equivalents	$6,237,610	$2,849,843
Restricted cash	301,349	1,285,820
Other short-term investments	250	—
Investment securities:		
Available-for-sale (amortized cost of $6,250,126 and $6,019,927 at August 31, 2012 and November 30, 2011, respectively)	6,377,502	6,107,831
Held-to-maturity (fair value of 92,268 and $96,042 at August 31, 2012 and November 30, 2011, respectively)	90,005	98,222
Total investment securities	6,467,507	6,206,053
Loan receivables:		
Mortgage loans held for sale, measured at fair value	272,082	—
Student loans held for sale	—	714,180
Loan portfolio:		
Credit card	48,124,468	46,638,625
Other	5,893,952	4,733,742
Purchased credit-impaired loans	4,867,010	5,250,388
Total loan portfolio	58,885,430	56,622,755
Total loan receivables	59,157,512	57,336,935
Allowance for loan losses	(1,687,664)	(2,205,196)
Net loan receivables	57,469,848	55,131,739
Premises and equipment, net	519,621	483,250
Goodwill	287,043	255,421
Intangible assets, net	192,181	188,018
Other assets	2,433,255	2,383,793
Total assets	$73,908,664	$68,783,937
Liabilities and Stockholders' Equity		
Deposits:		
Interest-bearing deposit accounts	$42,175,032	$39,463,887
Non-interest bearing deposit accounts	143,280	113,575
Total deposits	42,318,312	39,577,462
Short-term borrowings	250,139	50,000
Long-term borrowings	19,246,113	18,287,178
Accrued expenses and other liabilities	2,948,187	2,627,086
Total liabilities	64,762,751	60,541,726
Commitments, contingencies and guarantees (Notes 9, 12, and 13)		
Stockholders' Equity:		
Common stock, par value $.01 per share; 2,000,000,000 shares authorized; 552,572,624 and 549,748,783 shares issued at August 31, 2012 and November 30, 2011, respectively	5,526	5,497

Additional paid-in capital	3,570,371	3,507,754
Retained earnings	6,877,990	5,243,318
Accumulated other comprehensive loss	(31,326)	(51,679)
Treasury stock, at cost; 45,086,760 and 20,918,354 shares at August 31, 2012 and November 30, 2011, respectively	(1,276,648)	(462,679)
Total stockholders' equity	9,145,913	8,242,211
Total liabilities and stockholders' equity	$73,908,664	$68,783,937

The table below presents the carrying amounts of certain assets and liabilities of Discover Financial Services' consolidated variable interest entities (VIEs) which are included in the condensed consolidated statements of financial condition above. The assets in the table below include those assets that can only be used to settle obligations of the consolidated VIEs. The liabilities in the table below include third party liabilities of consolidated VIEs only, and exclude intercompany balances that eliminate in consolidation. The liabilities also exclude amounts for which creditors have recourse to the general credit of Discover Financial Services.

	August 31, 2012 (unaudited)	November 30, 2011
	(dollars in thousands)	
Assets		
Restricted cash	$295,439	$1,274,175
Credit card loan receivables	33,517,582	33,815,860
Purchased credit-impaired loans	2,631,970	2,839,871
Allowance for loan losses allocated to securitized loan receivables	(1,074,058)	(1,510,730)
Other assets	33,638	33,724
Liabilities		
Long-term borrowings	$17,337,914	$15,842,512
Accrued interest payable	13,906	13,184

See Notes to Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Income

	For the Three Months Ended August 31,		For the Nine Months Ended August 31,	
	2012	2011	2012	2011
	(unaudited)			
	(dollars in thousands, except per share amounts)			
Interest income:				
Credit card loans	$1,451,836	$1,423,496	$4,296,757	$4,243,803
Other loans	217,433	157,424	630,313	428,762
Investment securities	21,371	15,676	58,869	42,535
Other interest income	4,329	2,496	11,207	10,234
Total interest income	1,694,969	1,599,092	4,997,146	4,725,334
Interest expense:				
Deposits	204,982	241,719	650,213	749,584
Short-term borrowings	423	33	424	116
Long-term borrowings	119,905	120,301	368,472	375,060
Total interest expense	325,310	362,053	1,019,109	1,124,760
Net interest income	1,369,659	1,237,039	3,978,037	3,600,574
Provision for loan losses	126,288	99,514	510,401	692,763
Net interest income after provision for loan losses	1,243,371	1,137,525	3,467,636	2,907,811
Other income:				
Discount and interchange revenue, net	265,531	282,889	795,166	809,631
Protection products revenue	104,201	107,858	310,256	321,527
Loan fee income	80,012	84,243	241,719	250,596
Transaction processing revenue	59,168	43,931	163,823	131,792
Merchant fees	4,426	4,110	11,654	12,981
Gain (loss) on investments	—	(3,614)	28	(3,622)
Other income	80,912	32,546	154,247	135,526
Total other income	594,250	551,963	1,676,893	1,658,431
Other expense:				
Employee compensation and benefits	274,366	241,881	770,448	684,782
Marketing and business development	160,534	133,398	410,975	393,244
Information processing and communications	68,812	63,547	210,723	194,852
Professional fees	107,749	106,042	317,334	301,122
Premises and equipment	19,562	18,063	55,728	53,268
Other expense	194,884	79,476	486,194	245,431
Total other expense	825,907	642,407	2,251,402	1,872,699
Income before income tax expense	1,011,714	1,047,081	2,893,127	2,693,543
Income tax expense	385,028	398,263	1,098,844	979,414
Net income	$626,686	$648,818	$1,794,283	$1,714,129
Net income allocated to common stockholders	$620,770	$641,772	$1,776,770	$1,694,636
Basic earnings per share	$1.21	$1.18	$3.39	$3.11
Diluted earnings per share	$1.21	$1.18	$3.39	$3.11
Dividends paid per share	$0.10	$0.06	$0.30	$0.14

See Notes to the Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Comprehensive Income

	For the Three Months Ended August 31,		For the Nine Months Ended August 31,	
	2012	2011	2012	2011
	(unaudited)			
	(dollars in thousands, except per share amounts)			
Net income	$626,686	$648,818	$1,794,283	$1,714,129
Other comprehensive income, net of taxes				
Unrealized gain on securities available for sale, net of tax	9,931	38,170	24,626	54,897
Unrealized (loss) gain on cash flow hedges, net of tax	(241)	8,208	(2,497)	7,330
Unrealized pension and post-retirement benefit gain (loss), net of tax	—	1	(1,776)	342
Other comprehensive income	9,690	46,379	20,353	62,569
Comprehensive income	$636,376	$695,197	$1,814,636	$1,776,698

See Notes to the Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Changes in Stockholders’ Equity

	Common Stock						
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders’ Equity
	(unaudited) (dollars and shares in thousands)						
Balance at November 30, 2010	547,128	$5,471	$3,435,318	$3,126,488	$ (82,548)	$(27,883)	$6,456,846
Net income	—	—	—	1,714,129	—	—	1,714,129
Other comprehensive income	—	—	—	—	62,569	—	62,569
Purchases of treasury stock	—	—	—	—	—	(207,560)	(207,560)
Common stock issued under employee benefit plans	40	—	906	—	—	—	906
Common stock issued and stock-based compensation expense	2,308	24	56,439	—	—	—	56,463
Dividends—common stock	—	—	—	(77,437)	—	—	(77,437)
Balance at August 31, 2011	549,476	$5,495	$3,492,663	$4,763,180	$ (19,979)	$(235,443)	$8,005,916
Balance at November 30, 2011	549,749	$5,497	$3,507,754	$5,243,318	$ (51,679)	$(462,679)	$8,242,211
Net income	—	—	—	1,794,283	—	—	1,794,283
Other comprehensive income	—	—	—	—	20,353	—	20,353
Purchases of treasury stock	—	—	—	—	—	(813,969)	(813,969)
Common stock issued under employee benefit plans	41	—	1,323	—	—	—	1,323
Common stock issued and stock based compensation expense	2,783	29	61,294	—	—	—	61,323
Dividends—common stock	—	—	—	(159,611)	—	—	(159,611)
Balance at August 31, 2012	552,573	$5,526	$3,570,371	$6,877,990	$ (31,326)	$(1,276,648)	$9,145,913

See Notes to the Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Cash Flows

	For the Nine Months Ended August 31,	
	2012	2011
	(unaudited) (dollars in thousands)	
Cash flows from operating activities		
Net income	$1,794,283	$1,714,129
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	510,401	692,763
Deferred income taxes	159,001	351,854
Depreciation and amortization on premises and equipment	70,931	66,274
Amortization of deferred revenues	(154,008)	(191,290)
Other depreciation and amortization	(102,927)	(35,346)
(Gain) loss on investments	(28)	3,622
Loss on equity method and other investments	8,061	—
(Gain) loss on premises and equipment	(494)	3,242
Loss on sale of other assets	314	—
(Gain) on origination and sale of loans	(48,541)	(6,154)
Stock-based compensation expense	36,108	33,690
(Gain) on purchase of business	—	(15,917)
Proceeds from sale of mortgage loans originated for sale	550,815	—
Net principal disbursed on mortgage loans originated for sale	(782,677)	—
Changes in assets and liabilities:		
(Increase) decrease in other assets	(129,661)	32,339
Increase in accrued expenses and other liabilities	247,626	106,908
Net cash provided by operating activities	2,159,204	2,756,114
Cash flows from investing activities		
Maturities of other short-term investments	—	375,000
Purchases of other short-term investments	(250)	—
Maturities and sales of available-for-sale investment securities	1,558,449	786,463
Purchases of available-for-sale investment securities	(1,708,935)	(1,627,215)
Maturities of held-to-maturity investment securities	9,101	17,466
Purchases of held-to-maturity investment securities	(51,285)	(550)
Proceeds from sale of student loans held for sale	270,020	21,859
Net principal disbursed on loans originated for investment	(2,532,687)	(3,040,152)
Purchase of loan receivables	(390,075)	(596,163)
Purchase of net assets of a business	(48,886)	—
Purchase of business, net of cash acquired	—	(401,158)
Purchase of other investments	(27,168)	(15,000)
Decrease in restricted cash	985,338	623,794
Proceeds from sale of premises and equipment	515	13
Purchases of premises and equipment	(104,685)	(70,053)
Net cash used for investing activities	(2,040,548)	(3,925,696)
Cash flows from financing activities		
Net increase in short-term borrowings	200,139	100,000
Proceeds from issuance of securitized debt	5,099,617	2,500,000
Maturities and repayment of securitized debt	(3,648,040)	(5,114,986)

Repayment of long-term borrowings and bank notes	(12,681)	(345,048)
Premium paid on debt exchange	(114,493)	—
Proceeds from issuance of common stock	16,231	17,928
Purchases of treasury stock	(813,896)	(207,560)
Net increase in deposits	2,701,115	3,147,752
Dividends paid on common stock	(158,881)	(69,712)
Net cash provided by financing activities	3,269,111	28,374
Net increase (decrease) in cash and cash equivalents	3,387,767	(1,141,208)
Cash and cash equivalents, at beginning of period	2,849,843	5,098,733
Cash and cash equivalents, at end of period	$6,237,610	$3,957,525
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest expense	$898,126	$1,045,370
Income taxes, net of income tax refunds	$967,774	$635,360
Non-cash transactions:		
Initial fair value of contingent consideration to be paid for purchase of net assets of a business	$8,541	$—
Assumption of debt by buyer related to loans sold	$424,993	$—
Assumption of SLC debt	$—	$2,921,372

See Notes to the Condensed Consolidated Financial Statements.

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Notes to the Condensed Consolidated Financial Statements
(unaudited)

1. Background and Basis of Presentation

Description of Business. Discover Financial Services ("DFS" or the "Company") is a direct banking and payment services company. The Company is a bank holding company under the Bank Holding Company Act of 1956 as well as a financial holding company under the Gramm-Leach-Bliley Act and therefore is subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). Through its Discover Bank subsidiary, a Delaware state-chartered bank, the Company offers its customers credit card loans, private student loans, personal loans, and deposit products. Through its Discover Home Loans, Inc. subsidiary, the Company offers its customers home loans. The majority of the Direct Banking revenues relate to interest income earned on each of its loan products. Through its DFS Services LLC subsidiary and its subsidiaries, the Company operates the Discover Network, the PULSE Network ("PULSE"), and Diners Club International ("Diners Club"). The Discover Network is a payment card transaction processing network for Discover card-branded and third-party issued credit, debit and prepaid cards. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE network with access to ATMs domestically and internationally, as well as point of sale terminals at retail locations throughout the U.S. for debit card transactions. Diners Club is a global payments network of licensees, which are generally financial institutions, that issue Diners Club branded credit cards and/or provide card acceptance services.

The Company's business segments are Direct Banking and Payment Services. The Direct Banking segment includes consumer banking and lending products which includes Discover card-branded credit cards issued to individuals and small businesses on the Discover Network and other consumer products and services, including home loans, personal loans, private student loans, prepaid cards and other consumer lending and deposit products. The Payment Services segment includes PULSE, Diners Club and the Company's third-party issuing business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties.

Basis of Presentation. The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, the financial statements reflect all adjustments which are necessary for a fair presentation of the results for the quarter. All such adjustments are of a normal, recurring nature. The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and related disclosures. These estimates are based on information available as of the date of the condensed consolidated financial statements. The Company believes that the estimates used in the preparation of the condensed consolidated financial statements are reasonable. Actual results could differ from these estimates. These interim condensed consolidated financial statements should be read in conjunction with the Company's 2011 audited consolidated financial statements filed with the Company's annual report on Form 10-K for the fiscal year ended November 30, 2011.

Recently Issued Accounting Pronouncements. In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2012-02, Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. ASU 2012-02 applies to long-lived intangible assets, other than goodwill, that are not subject to amortization on the basis that they have indefinite useful lives. This standard is intended to simplify impairment testing by adding a qualitative review step to assess whether the required quantitative impairment analysis that exists today is necessary. Under the new standard, a company will not be required to calculate the fair value of the intangible asset unless it concludes, based on the qualitative assessment, that it is more likely than not that the fair value of that asset is less than its book value. If such a decline in fair value is deemed more likely than not to have occurred, then the quantitative impairment test that exists under current GAAP must be completed; otherwise, the asset is deemed to be not impaired and no further testing is required until the next annual test date (or sooner if conditions or events before that date raise concerns of potential impairment of the asset). The amended impairment guidance does not affect the manner in which fair value is determined. The new guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company's non-amortizable intangibles consist of $155 million in acquired trade names and other assets associated with Diners Club. The value of those assets will not be affected by the adoption of this standard.

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In December 2011, the FASB issued ASU No. 2011-11, Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. ASU 2011-11 adds certain additional disclosure requirements about financial instruments and derivatives instruments that are subject to netting arrangements. The Company has master netting arrangements pertaining to collateral posting requirements with its interest rate swap counterparties, as more fully discussed in Note 15: Derivatives and Hedging Activities. Additional details about these positions and how they are reported will be disclosed. The new disclosures are required for annual reporting periods beginning on or after January 1, 2013, and interim periods within those periods. Because this amendment impacts disclosures only, it will have no effect on the Company's financial condition, results of operations or cash flows.

In September 2011, the FASB issued ASU No. 2011-08, Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment. ASU 2011-08 is intended to simplify goodwill impairment testing by adding a qualitative review step to assess whether the required quantitative impairment analysis that exists today is necessary. Under the amended rule, a company will not be required to calculate the fair value of a business that contains recorded goodwill unless it concludes, based on the qualitative assessment, that it is more likely than not that the fair value of that business is less than its book value. If such a decline in fair value is deemed more likely than not to have occurred, then the quantitative goodwill impairment test that exists under current GAAP must be completed; otherwise, goodwill is deemed to be not impaired and no further testing is required until the next annual test date (or sooner if conditions or events before that date raise concerns of potential impairment in the business). The amended goodwill impairment guidance does not affect the manner in which a company estimates fair value. The new standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company has $287 million in goodwill, which is associated with its PULSE Network and Discover Home Loans, Inc. The value of that goodwill will not be affected by the adoption of this standard.

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income. This ASU will require companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. It eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The standard does not change the items which must be reported in other comprehensive income, how such items are measured or when they must be reclassified to net income. The FASB subsequently deferred the effective date of certain provisions of this standard pertaining to the reclassification of items out of accumulated other comprehensive income, pending the issuance of further guidance on that matter. Because this ASU impacts presentation only, it had no effect on the Company's financial condition, results of operations or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This ASU is intended to result in convergence between U.S. GAAP and International Financial Reporting Standards (“IFRS”) requirements for measurement of and disclosures about fair value. The amendments are not expected to have a significant impact on companies applying U.S. GAAP. Key provisions of the amendment include: a prohibition on grouping financial instruments for purposes of determining fair value, except when an entity manages market and credit risks on the basis of the entity’s net exposure to the group; an extension of the prohibition against the use of a blockage factor to all fair value measurements (that prohibition previously applied only to financial instruments with quoted prices in active markets); and a requirement that for recurring Level 3 fair value measurements, entities disclose quantitative information about unobservable inputs, a description of the valuation process used and qualitative details about the sensitivity of the measurements. In addition, for items not carried at fair value but for which fair value is disclosed, entities will be required to disclose the level within the fair value hierarchy that applies to the fair value measurement disclosed. The adoption of this ASU did not have a significant impact on the Company’s fair value measurements, financial condition, results of operations or cash flows.

In April 2011, the FASB issued ASU No. 2011-03, Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements. This ASU amends the sale accounting requirement concerning a transferor’s ability to repurchase transferred financial assets even in the event of default by the transferee, which typically is facilitated in a repurchase agreement by the presence of a collateral maintenance provision. Specifically, the level of cash collateral received by a transferor will no longer be relevant in determining whether a repurchase agreement constitutes a sale. As a result of this amendment, more repurchase agreements will be treated as secured financings rather than sales. This ASU became effective for the Company on March 1, 2012. Because essentially all repurchase agreements entered into by the Company have historically been deemed to constitute secured financing transactions, this amendment did not have an impact on the Company’s characterization of such transactions or on the Company's financial condition, results of operations or cash flows.

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2. Business Combinations

Acquisition of the net assets of the Home Loan Center, Inc. On June 6, 2012, through its Discover Home Loans, Inc. subsidiary, the Company acquired substantially all of the operating and related assets and certain liabilities of Home Loan Center, Inc. ("Home Loan Center"), a subsidiary of Tree.com, Inc., adding a residential mortgage lending component to the Company's direct banking business. In exchange for the net assets acquired, the Company paid an aggregate of $48.9 million, including payments made prior to the closing that were applied to the closing price. A portion of such amount is being held in escrow pending the Home Loan Center's ability to discharge certain contingent liabilities related to loans previously sold to secondary market investors. These contingent liabilities were not assumed by the Company. An additional $10.0 million of purchase price will be due from the Company on the first anniversary of the closing, subject to certain conditions being satisfied. The Company is finalizing its valuation analysis of assets acquired and liabilities assumed. The acquisition did not have a significant impact for the three or nine months ended August 31, 2012 on the Company's consolidated financial condition, results of operations or cash flows or on the Direct Banking reportable segment in which it is included.

Acquisition of The Student Loan Corporation. On December 31, 2010, the Company acquired The Student Loan Corporation (“SLC”), which is now a wholly-owned subsidiary of Discover Bank and included in the Company’s Direct Banking segment. The Company acquired SLC’s ongoing private student loan business, which includes certain private student loans held in three securitization trusts and other assets, and assumed SLC’s asset-backed securitization debt incurred by those trusts and other liabilities. The acquired loans are considered to be purchased credit-impaired ("PCI") loans for accounting purposes, the details of which are discussed further in Note 4: Loan Receivables. The acquisition significantly increased the size of the Company’s private student loan portfolio. In addition, the acquisition has provided the Company with a developed student loan business platform, additional school relationships and SLC’s website. Since the acquisition date, the results of operations and cash flows of SLC have been included in the Company’s condensed consolidated results of operations and cash flows. Pro forma data is not provided as the impact of the SLC acquisition was not significant to the Company’s condensed consolidated results of operations or cash flows.

Net cash consideration paid. The following table provides a calculation of the amount paid by the Company for SLC based on the net assets of the SLC securitization trusts acquired after applying an 8.5% discount to the trust assets (the “Trust Certificate Purchase Price”) (dollars in millions):

	Actual
Gross trust assets	$3,977
Less: 8.5% discount	(338)
Net trust assets	3,639
Less: Principal amount of and accrued interest on trust debt	(3,193)
Trust Certificate Purchase Price	$446

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Although the Company paid SLC shareholders $600 million for the acquisition of SLC ("Aggregate Merger Consideration"), the Company received a purchase price adjustment from Citibank, N.A. ("Citibank") equivalent to the amount by which the Aggregate Merger Consideration exceeded the value of the Trust Certificate Purchase Price. In addition, Citibank agreed to adjust the cash consideration paid by the Company to compensate it for (i) agreeing to commute certain insurance policies covering certain of the loans acquired and (ii) the value of non-trust related liabilities assumed by the Company. The following table provides a summary of total consideration paid by Discover including post-closing adjustments (dollars in millions):

	Actual	
Aggregate Merger Consideration	$600	
Less: Purchase price adjustment	(154	)
Trust Certificate Purchase Price	446	
Less: Further adjustments provided for by Citibank		
Cash received for consent to insurance commutation	(16	)
Cash received related to reimbursable liabilities	(29	)
Net cash consideration paid	$401	

Net assets acquired. The Company acquired net assets (including $155 million of cash) with an aggregate fair value of $563 million in exchange for cash consideration of $556 million, resulting in the recognition of a bargain purchase gain of approximately $7 million. The bargain purchase gain primarily resulted from Citibank's adjustment of the cash consideration to be paid by the Company in exchange for the Company's consent to permit SLC to commute, immediately prior to the acquisition, certain student loan insurance policies covering loans in one of the three trusts. The bargain purchase gain is recorded in other income on the Company's condensed consolidated statement of income. During the fourth quarter of 2011, the Company finalized its purchase accounting, which resulted in a decrease of $27 million in the indemnification asset and a $19 million increase in student loan receivables. In addition, there were immaterial changes made to the other assets purchased and liabilities assumed. These adjustments reflect the Company's finalized cash flow projections related to the student loans acquired. The offset to these adjustments resulted in a $9 million reduction in the originally estimated bargain purchase gain of $16 million.
The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of the SLC acquisition (dollars in thousands):

	At December 31, 2010
Student loan receivables	$ 3,070,042
Cash	155,347
Indemnification asset	74,571
Student relationships intangible	2,400
Trade name intangible	3,800
Total intangible assets	6,200
Other assets	217,441
Total assets acquired	3,523,601
Securitized debt	2,921,372
Other liabilities	38,889
Total liabilities assumed	2,960,261
Net assets acquired	$ 563,340

The Company acquired $6.2 million in identifiable intangible assets. These intangible assets consist of student relationships and trade name intangibles. Acquired student relationships consist of those relationships in existence between SLC and the numerous students that carry student loan balances. This intangible asset is deemed to have a finite useful life of 5 years and will be amortized over this period. Trade name intangibles relate to trademarks, trade names and internet domains and content. This intangible asset is deemed to have an indefinite useful life and therefore is not subject to amortization.

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The Company also recorded a $75 million indemnification asset. This asset reflects the discounted present value of payments expected to be received under Citibank's indemnification of student loan credit losses that would have been recoverable under certain student loan insurance policies which, as noted above, were commuted pursuant to an agreement entered into by SLC with the Company's consent immediately prior to the acquisition. The indemnification pertains only to loans in one of the three SLC securitization trusts that the Company acquired, namely the SLC Private Student Loan Trust 2010-A ("SLC 2010-A"). The SLC 2010-A trust included loans with an aggregate outstanding principal balance of $1.2 billion at the time of acquisition; outstanding loans in that trust totaled $1 billion as of August 31, 2012. The initial value of the indemnification asset was based on the amount of projected credit losses expected to be reimbursed by Citibank. Under the terms of the indemnification agreement with Citibank, indemnification payments related to student loan credit losses are subject to an overall cap of $166.8 million, consistent with the terms of the insurance policies which the indemnification serves to replace.

The subsequent accounting for the indemnification asset will generally reflect the manner in which the indemnified loans are subsequently measured. The value of the indemnification asset will increase or decrease as expected credit losses on the PCI student loans increase or decrease, respectively. An increase in expected losses on PCI student loans that results in the immediate recognition of an allowance for loan losses will result in an immediate increase in the indemnification asset. A decrease in expected losses that results in an immediate reversal of a previously recognized loan loss allowance will result in the immediate reduction of the indemnification asset. Recognition of an allowance for loan losses on PCI student loans is discussed in more detail within Note 4: Loan Receivables under "Purchased Credit-Impaired Loans." To the extent that a decrease in expected losses results in a prospective increase in the accretable yield on PCI student loans rather than an immediate reduction of the loan loss allowance, the value of the indemnification asset will be adjusted prospectively through a reduction in the rate of amortization. Amortization and valuation adjustments to the indemnification asset are recorded through other income on the condensed consolidated statement of income.

3. Investments

The Company's investment securities consist of the following (dollars in thousands):

	August 31, 2012	November 30, 2011
U.S. Treasury securities	$2,471,448	$2,563,800
U.S. government agency securities	2,319,285	2,795,223
States and political subdivisions of states	35,242	40,936
Other securities:		
Credit card asset-backed securities of other issuers	164,294	299,889
Corporate debt securities(1)	145,529	449,469
To-be-announced investment securities	—	50,254
Residential mortgage-backed securities - Agency (2)	1,331,709	6,482
Total other securities	1,641,532	806,094
Total investment securities	$6,467,507	$6,206,053

(1) Amount represents corporate debt obligations issued under the Temporary Liquidity Guarantee Program (TLGP) that are guaranteed by the Federal Deposit Insurance Corporation (FDIC).

(2) Consists of residential mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae.

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The amortized cost, gross unrealized gains and losses, and fair value of available-for-sale and held-to-maturity investment securities are as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At August 31, 2012				
Available-for-Sale Investment Securities[1]				
U.S. Treasury securities	$2,417,773	$53,125	$—	$2,470,898
U.S. government agency securities	2,267,348	51,937	—	2,319,285
Credit card asset-backed securities of other issuers	161,386	2,908	—	164,294
Corporate debt securities	145,396	133	—	145,529
Residential mortgage-backed securities - Agency	1,258,223	19,273	—	1,277,496
Total available-for-sale investment securities	$6,250,126	$127,376	$—	$6,377,502
Held-to-Maturity Investment Securities[2]				
U.S. Treasury securities[3]	$550	$—	$—	$550
States and political subdivisions of states	35,242	234	(302)	35,174
Residential mortgage-backed securities - Agency [4]	54,213	2,331	—	56,544
Total held-to-maturity investment securities	$90,005	$2,565	$(302)	$92,268
At November 30, 2011				
Available-for-Sale Investment Securities[1]				
U.S. Treasury securities	$2,516,008	$47,242	$—	$2,563,250
U.S. government agency securities	2,762,265	34,166	(1,208)	2,795,223
Credit card asset-backed securities of other issuers	293,231	6,658	—	299,889
Corporate debt securities	448,423	1,066	(20)	449,469
Total available-for-sale investment securities	$6,019,927	$89,132	$(1,228)	$6,107,831
Held-to-Maturity Investment Securities[2]				
U.S. Treasury securities[3]	$550	$—	$—	$550
States and political subdivisions of states	40,936	197	(2,823)	38,310
Residential mortgage-backed securities - Agency [4]	6,482	650	—	7,132
To-be-announced investment securities	50,254	—	(204)	50,050
Total held-to-maturity investment securities	$98,222	$847	$(3,027)	$96,042

(1) Available-for-sale investment securities are reported at fair value.
(2) Held-to-maturity investment securities are reported at amortized cost.
(3) Amount represents securities pledged as collateral to a government-related merchant for which transaction settlement occurs beyond the normal 24-hour period.
(4) Amounts represent residential mortgage-backed securities that were classified as held-to-maturity as they were entered into as a part of the Company's community reinvestment initiatives.

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The following table provides information about investment securities with aggregate gross unrealized losses and the length of time that individual investment securities have been in a continuous unrealized loss position as of August 31, 2012 and November 30, 2011 (dollars in thousands):

	Number of Securities in a Loss Position	Less than 12 months		More than 12 months	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At August 31, 2012					
Held-to-Maturity Investment Securities					
State and political subdivisions of states	3	$—	$—	$13,183	$302
At November 30, 2011					
Available-for-Sale Investment Securities					
U.S. government agency securities	2	$242,898	$1,208	$—	$—
Corporate debt securities	3	$100,041	$20	$—	$—
Held-to-Maturity Investment Securities					
State and political subdivisions of states	6	$2,689	$46	$27,768	$2,777
To-be-announced investment securities	2	$50,050	$204	$—	$—

During the three and nine months ended August 31, 2012, the Company received $473.7 million and $1.6 billion of proceeds related to maturities, redemptions, or liquidation of investment securities, as compared to $170.5 million and $803.9 million for the three and nine months ended August 31, 2011.

During the three and nine months ended August 31, 2012, and during the three months ended August 31, 2011, there were no sales of securities. During the nine months ended August 31, 2011, the Company received $161 thousand of proceeds and recorded $146 thousand of gross realized gains relating primarily to the sale of equity securities.

The Company records unrealized gains and losses on its available-for-sale investment securities in other comprehensive income. For the three and nine months ended August 31, 2012, the Company recorded net unrealized gains of $15.9 million ($9.9 million after tax) and $39.5 million ($24.6 million after tax), respectively, in other comprehensive income. For the three and nine months ended August 31, 2011, the Company recorded net unrealized gains of $61.0 million ($38.2 million after tax) and $87.7 million ($54.9 million after tax), respectively, in other comprehensive income.

At August 31, 2012 and November 30, 2011, the Company had $302 thousand and $2.8 million, respectively, of gross unrealized losses in a continuous loss position for more than 12 months on its held-to-maturity investment securities in states and political subdivisions of states. The Company believes the unrealized loss on these investments is the result of changes in interest rates subsequent to the Company's acquisitions of these securities and that the reduction in value is temporary. The Company does not intend to sell these investments nor does it expect to be required to sell these investments before recovery of their amortized cost basis, as they were entered into as a part of the Company's community reinvestment initiatives. The Company expects to collect all amounts due according to the contractual terms of these securities.

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Contractual maturities of available-for-sale debt securities and held-to-maturity debt securities at August 31, 2012 are provided in the table below (dollars in thousands):

	One Year or Less	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years	Total
Available-for-sale—Amortized Cost(1)					
U.S. Treasury securities	$175,393	$2,242,380	$—	$—	$2,417,773
U.S. government agency securities	567,952	1,699,396	—	—	2,267,348
Credit card asset-backed securities of other issuers	142,855	18,531	—	—	161,386
Corporate debt securities	145,396	—	—	—	145,396
Residential mortgage-backed securities - Agency	—	—	326,189	932,034	1,258,223
Total available-for-sale investment securities	$1,031,596	$3,960,307	$326,189	$932,034	$6,250,126
Held-to-maturity—Amortized Cost(2)					
U.S. Treasury securities	$550	$—	$—	$—	$550
State and political subdivisions of states	1,385	3,285	—	30,572	35,242
Residential mortgage-backed securities - Agency(3)	—	—	—	54,213	54,213
Total held-to-maturity investment securities	$1,935	$3,285	$—	$84,785	$90,005
Available-for-sale—Fair Values(1)					
U.S. Treasury securities	$175,949	$2,294,949	$—	$—	$2,470,898
U.S. government agency securities	570,147	1,749,138	—	—	2,319,285
Credit card asset-backed securities of other issuers	144,788	19,506	—	—	164,294
Corporate debt securities	145,529	—	—	—	145,529
Residential mortgage-backed securities - Agency	—	—	329,418	948,078	1,277,496
Total available-for-sale investment securities	$1,036,413	$4,063,593	$329,418	$948,078	$6,377,502
Held-to-maturity—Fair Values(2)					
U.S. Treasury securities	$550	$—	$—	$—	$550
State and political subdivisions of states	1,387	3,350	—	30,437	35,174
Residential mortgage-backed securities - Agency(3)	—	—	—	56,544	56,544
Total held-to-maturity investment securities	$1,937	$3,350	$—	$86,981	$92,268

(1) Available-for-sale investment securities are reported at fair value.
(2) Held-to-maturity investment securities are reported at amortized cost.
(3) Amounts represent residential mortgage-backed securities that were classified as held-to-maturity as they were entered into as a part of the Company's community reinvestment initiatives.

Other Investments. As a part of the Company's community reinvestment initiatives, the Company has made equity investments in certain limited partnerships and limited liability companies that finance the construction and rehabilitation of affordable rental housing, as well as stimulate economic development in low to moderate income communities. These investments are accounted for using the equity method of accounting, and are recorded within other assets, and the related commitment for future investments is recorded in other liabilities within the statement of financial condition. The portion of each investment's operating results allocable to the Company is recorded in other expense within the condensed consolidated statement of income. The Company earns a return primarily through the receipt of tax credits allocated to the affordable housing projects and the community revitalization projects. These investments are not consolidated as the Company does not have a controlling financial interest in the entities. As of August 31, 2012 and November 30, 2011, the Company had outstanding investments of $194.8 million and $137.9 million, respectively, in these entities, and the related contingent liability was $52.6 million and $6.3 million, respectively.

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4. Loan Receivables

The Company has three portfolio segments: credit card loans, other loans and PCI student loans acquired in the SLC transaction (See Note 2: Business Combinations) and in a separate portfolio acquisition from Citibank. Within these portfolio segments, the Company has classes of receivables which are depicted in the table below (dollars in thousands):

	August 31, 2012	November 30, 2011
Student loans held for sale(1)	$—	$714,180
Mortgage loans held for sale(2)	272,082	—
Loan portfolio:		
Credit card loans:		
Discover card(3)	47,915,177	46,419,544
Discover business card	209,291	219,081
Total credit card loans	48,124,468	46,638,625
Other loans:		
Personal loans	3,114,408	2,648,051
Private student loans	2,752,715	2,069,001
Other	26,829	16,690
Total other loans	5,893,952	4,733,742
PCI student loans(4)	4,867,010	5,250,388
Total loan portfolio	58,885,430	56,622,755
Total loan receivables	59,157,512	57,336,935
Allowance for loan losses	(1,687,664)	(2,205,196)
Net loan receivables	$57,469,848	$55,131,739

(1) Amount represents federal student loans. At November 30, 2011, $446.6 million of federal student loan receivables were pledged as collateral against a long-term borrowing. During first quarter 2012, Discover Bank sold these loans and recorded a loss of $518 thousand. As a part of this transaction, the related borrowings were assumed by the purchaser.

(2) All mortgage loans held for sale are pledged as collateral against the warehouse line of credit used to fund consumer residential loans. See Note 7: Borrowings.

(3) Amounts include $19.9 billion and $18.5 billion underlying investors' interest in trust debt at August 31, 2012 and November 30, 2011, respectively, and $13.6 billion and $15.4 billion in seller's interest at August 31, 2012 and November 30, 2011, respectively. See Note 5: Credit Card and Student Loan Securitization Activities for further information.

(4) Amounts include $2.6 billion and $2.8 billion of loans pledged as collateral against the notes issued from the SLC securitization trusts at August 31, 2012 and November 30, 2011, respectively. See Note 5: Credit Card and Student Loan Securitization Activities. Of the remaining $2.3 billion and $2.5 billion at August 31, 2012 and November 30, 2011, respectively, that were not pledged as collateral, approximately $14.7 million and $12.8 million represent loans eligible for reimbursement through an indemnification claim. Discover Bank must purchase such loans from the trust before a claim may be filed.

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Credit Quality Indicators. The Company regularly reviews its collection experience (including delinquencies and net charge-offs) in determining its allowance for loan losses. Credit card and closed-end consumer loan receivables are placed on nonaccrual status upon receipt of notification of the bankruptcy or death of a customer or suspected fraudulent activity on an account. Upon completion of the fraud investigation, loan receivables may resume accruing interest.
Information related to the delinquencies and net charge-offs in the Company’s loan portfolio, which excludes loans held for sale, is shown below by each class of loan receivables except for PCI student loans, which is shown under the heading “Purchased Credit-Impaired Loans” (dollars in thousands):

Delinquent and Non-Accruing Loans:

	30-89 Days Delinquent	90 or More Days Delinquent	Total Past Due	90 or More Days Delinquent and Accruing	Total Non-accruing[2]
At August 31, 2012					
Credit card loans:					
Discover card[1]	$441,545	$424,514	$866,059	$374,035	$ 179,716
Discover business card	1,803	2,483	4,286	2,377	489
Total credit card loans	443,348	426,997	870,345	376,412	180,205
Other loans:					
Personal loans	16,395	6,784	23,179	6,021	4,229
Private student loans (excluding PCI)	29,314	5,876	35,190	4,832	1,237
Other	502	1,637	2,139	—	1,889
Total other loans (excluding PCI)	46,211	14,297	60,508	10,853	7,355
Total loan receivables (excluding PCI)	$489,559	$441,294	$930,853	$387,265	$ 187,560
At November 30, 2011					
Credit card loans:					
Discover card[1]	$554,354	$556,126	$1,110,480	$498,305	$ 200,208
Discover business card	2,823	3,548	6,371	3,335	860
Total credit card loans	557,177	559,674	1,116,851	501,640	201,068
Other loans:					
Personal loans	15,604	7,362	22,966	6,636	3,628
Private student loans (excluding PCI)	10,073	2,992	13,065	2,883	125
Other	507	2,091	2,598	—	2,317
Total other loans (excluding PCI)	26,184	12,445	38,629	9,519	6,070
Total loan receivables (excluding PCI)	$583,361	$572,119	$1,155,480	$511,159	$ 207,138

(1) Consumer credit card loans that are 90 or more days delinquent and accruing interest include $31.8 million and $37.9 million of loans accounted for as troubled debt restructurings at August 31, 2012 and November 30, 2011, respectively.

(2) The Company estimates that the gross interest income that would have been recorded in accordance with the original terms of these credit card loans was $7.8 million and $24.5 million for the three and nine months ended August 31, 2012, respectively. The Company does not separately track the amount of gross interest income that would have been recorded in accordance with the original terms of loans. These amounts were estimated based on customers' current balances and most recent rates.

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Net Charge-offs. The Company's net charge-offs include the principal amount of losses charged off less principal recoveries and exclude charged-off interest and fees, recoveries of interest and fees and fraud losses. Charged-off and recovered interest and fees are recorded in interest and loan fee income, respectively, which is effectively a reclassification of the loan loss provision, while fraud losses are recorded in other expense. Credit card loan receivables are charged off at the end of the month during which an account becomes 180 days contractually past due. Closed-end consumer loan receivables are generally charged off at the end of the month during which an account becomes 120 days contractually past due. Generally, customer bankruptcies and probate accounts are charged off at the end of the month 60 days following the receipt of notification of the bankruptcy or death but not later than the 180-day or 120-day contractual time frame.

Net Charge-Offs:	For the Three Months Ended August 31,					
	2012			2011		
	Net Charge-offs	Net Charge-off Rate		Net Charge-offs	Net Charge-off Rate	
Credit card loans:						
Discover card	$285,345	2.42	%	$436,242	3.84	%
Discover business card	1,741	3.34	%	3,506	6.01	%
Total credit card loans	287,086	2.43	%	439,748	3.85	%
Other loans:						
Personal loans	16,214	2.14	%	16,000	2.73	%
Private student loans (excluding PCI)	4,674	0.73	%	2,618	0.62	%
Other	(97)	(0.26	)%	410	13.41	%
Total other loans (excluding PCI)	20,791	1.45	%	19,028	0.98	%
Net charge-offs as a percentage of total loans (excluding PCI)	$307,877	2.32	%	$458,776	3.63	%
Net charge-offs as a percentage of total loans (including PCI)	$307,877	2.12	%	$458,776	3.43	%

	For the Nine Months Ended August 31,					
	2012			2011		
	Net Charge-offs	Net Charge-off Rate		Net Charge-offs	Net Charge-off Rate	
Credit card loans:						
Discover card	$960,403	2.76	%	$1,651,311	4.91	%
Discover business card	5,941	3.75	%	14,937	8.26	%
Total credit card loans	966,344	2.76	%	1,666,248	4.93	%
Other loans:						
Personal loans	49,869	2.32	%	50,980	3.19	%
Private student loans (excluding PCI)	11,650	0.64	%	5,573	0.49	%
Other	70	0.14	%	1,022	10.35	%
Total other loans (excluding PCI)	61,589	1.48	%	57,575	1.09	%
Net charge-offs as a percentage of total loans (excluding PCI)	$1,027,933	2.63	%	$1,723,823	4.64	%
Net charge-offs as a percentage of total loans (including PCI)	$1,027,933	2.39	%	$1,723,823	4.41	%

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As part of credit risk management activities, on an ongoing basis the Company reviews information related to the performance of a customer's account with the Company as well as information from credit bureaus, such as a FICO or other credit scores, relating to the customer's broader credit performance. Credit scores are generally obtained at origination of the account and are refreshed monthly or quarterly thereafter to assist in predicting customer behavior. Historically, the Company has noted that a significant proportion of delinquent accounts have FICO scores below 660. The following table provides FICO scores available for the Company's customers as a percentage of each class of loan receivables:

	August 31, 2012		November 30, 2011	
	660 and Above	Less than 660 or No Score	660 and Above	Less than 660 or No Score
Discover card	83 %	17 %	81 %	19 %
Discover business card	91 %	9 %	89 %	11 %
Personal loans	97 %	3 %	97 %	3 %
Private student loans (excluding PCI)(1)	95 %	5 %	95 %	5 %

(1) PCI loans are discussed under the heading "Purchased Credit-Impaired Loans."

For private student loans, additional credit risk management activities include monitoring the amount of loans in forbearance. Forbearance allows borrowers experiencing temporary financial difficulties and willing to make payments the ability to temporarily suspend payments. Eligible borrowers have a lifetime cap on forbearance of 12 months. At August 31, 2012 and November 30, 2011, there were $105.5 million and $75.9 million of loans in forbearance, respectively. In addition, at August 31, 2012 and November 30, 2011, there were 2.0% and 1.5% of private student loans in forbearance as a percentage of student loans in repayment and forbearance.

Allowance for Loan Losses. The Company maintains an allowance for loan losses at an appropriate level to absorb probable losses inherent in the loan portfolio. The Company considers the collectibility of all amounts contractually due on its loan receivables, including those components representing interest and fees. Accordingly, the allowance for loan losses represents the estimated uncollectible principal, interest and fee components of loan receivables. The allowance is evaluated monthly and is maintained through an adjustment to the provision for loan losses. Charge-offs of principal amounts of loans outstanding are deducted from the allowance and subsequent recoveries of such amounts increase the allowance. Charge-offs of loan balances representing unpaid interest and fees result in a reversal of interest and fee income, respectively, which is effectively a reclassification of provision for loan losses.

The Company bases its allowance for loan losses on several analyses that help estimate incurred losses as of the balance sheet date. While the Company's estimation process includes historical data and analysis, there is a significant amount of judgment applied in selecting inputs and analyzing the results produced by the models to determine the allowance. The Company uses a migration analysis to estimate the likelihood that a loan will progress through the various stages of delinquency. The loan balances used in the migration analysis represent all amounts contractually due and, as a result, the migration analysis captures principal, interest and fee components in estimating uncollectible accounts. The Company uses other analyses to estimate losses incurred on non-delinquent accounts. The considerations in these analyses include past performance, risk management techniques applied to various accounts, historical behavior of different account vintages, current economic conditions, recent trends in delinquencies, bankruptcy filings, account collection management, policy changes, account seasoning, loan volume and amounts, payment rates, and forecasting uncertainties. The Company does not evaluate loans for impairment on an individual basis, but instead estimates its allowance for loan losses on a pooled basis, which includes loans that are delinquent and/or no longer accruing interest and/or certain loans that have defaulted from a loan modification program, as discussed below under the section entitled "Impaired Loans and Troubled Debt Restructurings."

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The following table provides changes in the Company's allowance for loan losses for the three and nine months ended August 31, 2012 and 2011 (dollars in thousands):

	For the Three Months Ended August 31,		For the Nine Months Ended August 31,	
	2012	2011	2012	2011
Balance at beginning of period	$1,869,253	$2,632,320	$2,205,196	$3,304,118
Additions:				
Provision for loan losses	126,288	99,514	510,401	692,763
Deductions:				
Charge-offs:				
Discover card	(428,935)	(584,534)	(1,400,273)	(2,085,452)
Discover business card	(2,623)	(4,416)	(8,540)	(17,672)
Total credit card loans	(431,558)	(588,950)	(1,408,813)	(2,103,124)
Personal loans	(17,341)	(16,458)	(52,474)	(52,438)
Private student loans	(4,793)	(2,663)	(11,956)	(5,646)
Other	(22)	(411)	(194)	(1,025)
Total other loans	(22,156)	(19,532)	(64,624)	(59,109)
Total charge-offs	(453,714)	(608,482)	(1,473,437)	(2,162,233)
Recoveries:				
Discover card	143,590	148,292	439,870	434,141
Discover business card	882	910	2,599	2,735
Total credit card loans	144,472	149,202	442,469	436,876
Personal loans	1,127	458	2,605	1,458
Private student loans	119	45	306	73
Other	119	1	124	3
Total other loans	1,365	504	3,035	1,534
Total recoveries	145,837	149,706	445,504	438,410
Net charge-offs	(307,877)	(458,776)	(1,027,933)	(1,723,823)
Balance at end of period	$1,687,664	$2,273,058	$1,687,664	$2,273,058

Net charge-offs of principal are recorded against the allowance for loan losses, as shown in the table above. Information regarding net charge-offs of interest and fee revenues on credit card and other loans is as follows (dollars in thousands):

	For the Three Months Ended August 31,		For the Nine Months Ended August 31,	
	2012	2011	2012	2011
Interest accrued subsequently charged off, net of recoveries (recorded as a reduction of interest income)	$76,942	$128,329	$272,345	$480,044
Fees accrued subsequently charged off, net of recoveries (recorded as a reduction to other income)	$14,845	$22,807	$52,503	$86,762

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The following table provides additional detail of the Company's allowance for loan losses and recorded investment in its loan portfolio (which excludes loans held for sale) by impairment methodology (dollars in thousands):

	Credit Card	Personal Loans	Student Loans	Other Loans	Total
At August 31, 2012					
Allowance for loans evaluated for impairment as:					
Collectively evaluated for impairment(1)	$1,331,282	$92,069	$65,203	$783	$1,489,337
Troubled debt restructurings(2)	190,981	4,287	3,059	—	198,327
Purchased credit-impaired(3)	—	—	—	—	—
Total allowance for loan losses	$1,522,263	$96,356	$68,262	$783	$1,687,664
Recorded investment in loans evaluated for impairment as:					
Collectively evaluated for impairment(1)	$47,007,109	$3,098,013	$2,740,212	$26,829	$52,872,163
Troubled debt restructurings(2)	1,117,359	16,395	12,503	—	1,146,257
Purchased credit-impaired(3)	—	—	4,867,010	—	4,867,010
Total recorded investment	$48,124,468	$3,114,408	$7,619,725	$26,829	$58,885,430
At November 30, 2011					
Allowance for loans evaluated for impairment as:					
Collectively evaluated for impairment(1)	$1,865,797	$81,838	$52,601	$220	$2,000,456
Troubled debt restructurings(2)	204,364	237	139	—	204,740
Purchased credit-impaired(3)	—	—	—	—	—
Total allowance for loan losses	$2,070,161	$82,075	$52,740	$220	$2,205,196
Recorded investment in loans evaluated for impairment as:					
Collectively evaluated for impairment(1)	$45,421,887	$2,640,416	$2,063,562	$16,690	$50,142,555
Troubled debt restructurings(2)	1,216,738	7,635	5,439	—	1,229,812
Purchased credit-impaired(3)	—	—	5,250,388	—	5,250,388
Total recorded investment	$46,638,625	$2,648,051	$7,319,389	$16,690	$56,622,755

(1) Represents loans evaluated for impairment in accordance with ASC 450-20, Loss Contingencies.

(2) Represents loans evaluated for impairment in accordance with ASC 310-40, Receivables, which consists of modified loans accounted for as troubled debt restructurings. The unpaid principal balance of credit card loans was $955.4 million and $1.0 billion at August 31, 2012 and November 30, 2011 respectively. The unpaid principal balance of personal loans was $16.1 million and $7.5 million at August 31, 2012 and November 30, 2011, respectively. The unpaid principal balance of student loans was $11.7 million and $5.4 million at August 31, 2012 and November 30, 2011, respectively. All loans accounted for as troubled debt restructurings have a related allowance for loan losses.

(3) Represents loans evaluated for impairment in accordance with ASC 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality.

Impaired Loans and Troubled Debt Restructurings. Permanent and certain temporary modifications on credit card loans, certain grants of student loan forbearance and certain modifications to personal loans are considered troubled debt restructurings and are accounted for in accordance with ASC 310-40, Troubled Debt Restructurings by Creditors. Generally loans included in a loan modification program are considered to be individually impaired and are accounted for as troubled debt restructurings. The Company has both internal and external loan modification programs that provide relief to credit card and personal loan borrowers who are experiencing financial hardship. The internal loan modification programs include both temporary and permanent programs.

For our credit card customers, the temporary hardship program primarily consists of a reduced minimum payment and an interest rate reduction, both lasting for a period no longer than 12 months. The permanent workout program involves changing the structure of the loan to a fixed payment loan with a maturity no longer than 60 months and reducing the interest rate on the loan. The permanent program does not normally provide for the forgiveness of unpaid principal, but may allow for the reversal of certain unpaid interest or fee assessments. The Company also makes loan modifications for customers who request financial assistance through external sources, such as a consumer credit counseling agency program (referred to here as external programs). These loans typically receive a reduced interest rate but continue to be subject to the original minimum payment terms and do not normally include waiver of unpaid principal, interest or fees.

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To assist student loan borrowers who are experiencing temporary financial difficulties and are willing to resume making payments, the Company may offer forbearance periods of up to 12 months over the life of the loan. The Company does not anticipate significant shortfalls in the contractual amount due for borrowers using a first forbearance period as the historical performance of these borrowers is not significantly different from the overall portfolio. However, when a delinquent borrower is granted a second forbearance period, the forbearance is considered a troubled debt restructuring.

For our personal loan customers, the temporary programs normally consist of a reduction of the minimum payment for a period of no longer than 12 months with a final balloon payment required at the end of the loan term. The permanent program involves changing the terms of the loan in order to pay off the outstanding balance over the new term for a period no longer than four years. The total term generally does not exceed nine years. The Company also allows loan modifications for personal loan customers who request financial assistance through external sources, similar to our credit card customers discussed above. Payments are modified based on the new terms agreed upon with the credit counseling agency. Personal loans modified through temporary and permanent internal programs are accounted for as troubled debt restructurings.

Loans classified as troubled debt restructurings are recorded at their present value with impairment measured as the difference between the loan balance and the discounted present value of cash flows expected to be collected. Consistent with the Company’s measurement of impairment of modified loans on a pooled basis, the discount rate used for credit card loans in internal programs is the average current annual percentage rate it applies to non-impaired credit card loans, which approximates what would have applied to the pool of modified loans prior to impairment. The discount rate used for credit card loans in external programs reflects a rate that is consistent with rates offered to lower risk cardmembers. For private student and personal loans, the discount rate used is the average contractual rate prior to modification.

Interest income from loans accounted for as troubled debt restructurings is accounted for in the same manner as other accruing loans. Cash collections on these loans are allocated according to the same payment hierarchy methodology applied to loans that are not in such programs. Additional information about modified loans is shown below (dollars in thousands):

	Average recorded investment in loans	Interest income recognized on impaired loans(1)	Gross interest income that would have been recorded with original terms(2)
For the Three Months Ended August 31, 2012			
Credit card loans			
Modified credit card loans that have reverted to pre-modification payment terms(3)	$240,895	$12,350	N/A
Internal programs	$560,327	$4,168	$18,388
External programs	$586,547	$12,694	$2,035
Personal loans(4)	$15,370	$454	N/A
Student loans(4)	$11,058	$204	N/A
For the Three Months Ended August 31, 2011			
Credit card loans			
Internal programs	$519,884	$4,518	$16,411
External programs	$709,211	$15,391	$2,467

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	Average recorded investment in loans	Interest income recognized on impaired loans[1]	Gross interest income that would have been recorded with original terms[2]
For the Nine Months Ended August 31, 2012			
Credit card loans			
Modified credit card loans that have reverted to pre-modification payment terms[3]	$248,118	$35,456	N/A
Internal programs	$564,650	$13,162	$54,922
External programs	$618,120	$39,905	$6,396
Personal loans[4]	$13,349	$1,222	N/A
Student loans[4]	$8,563	$469	N/A
For the Nine Months Ended August 31, 2011			
Credit card loans			
Internal programs	$534,479	$16,660	$47,950
External programs	$727,113	$46,974	$7,535

(1) The Company does not separately track interest income on all of its loans modification programs. Amounts shown are estimated by applying an average interest rate to the average loans in the various modification programs.

(2) The Company does not separately track the amount of gross interest income that would have been recorded if the loans in modification programs had not been restructured and interest had instead been recorded in accordance with the original terms. Amounts shown are estimated by applying the difference between the average interest rate earned on non-impaired credit card loans and the average interest rate earned on loans in the modification programs to the average loans in the modification programs.

(3) This balance is considered impaired, but is excluded from the internal and external program amounts reflected in this table. Represents credit card loans that were modified in troubled debt restructurings but that have subsequently reverted back to the loans' pre-modification payment terms either due to noncompliance with the terms of the modification or successful completion of a temporary modification program.

(4) As interest rates for personal loan customers in modification programs and student loan customers that have been granted forbearance periods are rarely modified, gross interest income that would have been recorded with original terms is not significant.

In order to evaluate the primary financial effects which resulted from loans entering into a loan modification program during the three and nine months ended August 31, 2012 and 2011, the Company quantified the amount by which interest and fees were reduced during the period. During the three and nine months ended August 31, 2012, the Company forgave approximately $10.2 million and $34.5 million, respectively, of interest and fees as a result of accounts entering into a loan modification program. During the three and nine months ended August 31, 2011, the Company forgave approximately $15.0 million and $49.1 million, respectively, of interest and fees as a result of accounts entering into a loan modification program.

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The following table provides information on loans that entered a loan modification program during the period (dollars in thousands):

	For the Three Months Ended August 31,			
	2012		2011	
	Number of Accounts	Balances	Number of Accounts	Balances
Accounts that entered a loan modification program during the period:				
Credit card:				
Internal programs	11,781	$78,607	16,680	$115,301
External programs	9,781	$54,133	12,951	$73,734
Personal loans	489	$6,282	287	$3,641
Student loans	130	$3,351	78	$1,461

	For the Nine Months Ended August 31,			
	2012		2011	
	Number of Accounts	Balances	Number of Accounts	Balances
Accounts that entered a loan modification program during the period:				
Credit card:				
Internal programs	41,279	$283,126	50,011	$351,968
External programs	30,596	$173,585	39,046	$230,720
Personal loans	1,047	$13,383	595	$7,337
Student loans	352	$8,164	167	$3,234

The following table presents the carrying value of loans that experienced a payment default during the three and nine months ended August 31, 2012 and 2011 that had been modified in a troubled debt restructuring during the 15 months preceding the end of each period (dollars in thousands):

	For the Three Months Ended August 31,			
	2012		2011	
	Number of Accounts	Aggregated Outstanding Balances Upon Default	Number of Accounts	Aggregated Outstanding Balances Upon Default
Troubled debt restructurings that subsequently defaulted:				
Credit card (1)(2)(3):				
Internal programs	3,721	$24,761	4,027	$28,191
External programs	2,509	$11,551	2,763	$13,912
Personal loans	77	$882	37	$468
Student loans	28	$691	1	$13

	For the Nine Months Ended August 31,			
	2012		2011	
	Number of Accounts	Aggregated Outstanding Balances	Number of Accounts	Aggregated Outstanding Balances

		Upon Default		Upon Default
Troubled debt restructurings that subsequently defaulted:				
Credit card [1][2][3]:				
Internal programs	12,331	$83,859	14,233	$102,113
External programs	6,122	$29,253	9,558	$49,956
Personal loans	228	$2,770	86	$1,083
Student loans	63	$1,459	6	$118

(1) The outstanding balance upon default is the loan balance at the end of the month prior to default.
(2) A customer defaults from a modification program after two consecutive missed payments.
(3) Terms revert back to the pre-modification terms for customers who default from a temporary program and charging privileges remain revoked.

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Of the account balances that defaulted as shown above for the three and nine months ended August 31, 2012, approximately 45% and 47%, respectively, of the total balances charged off at the end of the month in which they defaulted. Of the account balances that defaulted as shown above for the three and nine months ended August 31, 2011, approximately 42% and 39%, respectively, of the total balances charged off at the end of the month in which they defaulted. For accounts that have defaulted from a loan modification program and that have not subsequently charged off, the balances are included in the allowance for loan loss analysis discussed above under the section entitled "Allowance for Loan Losses."

Purchased Credit-Impaired Loans. Purchased loans with evidence of credit deterioration since origination for which it is probable that not all contractually required payments will be collected are considered impaired at acquisition and are reported as PCI loans. The private student loans acquired in the SLC transaction as well as the additional private student loan portfolio acquired from Citibank comprise the Company's only PCI loans at August 31, 2012 and November 30, 2011. Total PCI student loans had an outstanding balance of $5.4 billion and $5.7 billion, including accrued interest, and a related carrying amount of $4.9 billion and $5.3 billion, as of August 31, 2012 and November 30, 2011, respectively.

Management concluded it is probable that the Company will be unable to collect all contractually required payments due but the Company is unable to specifically identify which loans the Company will be unable to collect. Therefore, the Company has elected to apply ASC 310-30, Receivables-Loans and Debt Securities Acquired with Deteriorated Credit Quality by analogy to the entire pool of acquired loans.

At the time of acquisition, these loans were recorded at fair value. The Company estimated the initial fair value of the acquired loans based on the cash flows expected to be collected, discounted at a market rate of interest. Expected cash flows used in the initial fair value measurements reflect the effect of expected losses and prepayments as well as anticipated changes in the interest rate indices applicable to these variable rate loans.

As of the acquisition date of December 31, 2010, the PCI student loans acquired in the SLC transaction had an aggregate outstanding balance of approximately $3.8 billion, including accrued interest, and a fair value (initial carrying value) of approximately $3.1 billion. Of the $3.8 billion aggregate outstanding balance of loans acquired, loans with an aggregate outstanding balance of approximately $31 million were non-accruing as of the acquisition date.

As of the acquisition date of September 30, 2011, the private student loans acquired from Citibank had an aggregate outstanding balance and an estimated fair value of approximately $2.4 billion. These loans were acquired at a discount which reflects a decline in the credit quality of the loans after their origination. The discount is partially offset by a premium which reflects the value in certain loans that carry interest rates above prevailing market rates at the acquisition date. Of the $2.4 billion aggregate outstanding balance of loans acquired, loans with an outstanding balance of approximately $16 million were non-performing as of the acquisition date. There has not been any significant incremental credit deterioration on either portfolio since the respective acquisition dates and, therefore, no allowance has been established for the PCI student loans at August 31, 2012.

Certain PCI student loans in one of the three SLC securitization trusts are covered by an indemnification agreement with Citibank for credit losses. The indemnified loans are presented along with all other PCI student loans and the related indemnification asset is recognized as a separate asset on the Company's condensed consolidated statement of financial condition. See Note 2: Business Combinations for a description of the indemnification asset.

The following table shows contractually required payments receivable, cash flows expected to be collected and fair value of loans acquired as of the acquisition date (dollars in millions):

	At December 31, 2010
Contractually required payments receivable [1]	$ 5,673
Less: Non-accretable difference [2]	(683)
Cash flows expected to be collected	4,990
Less: Accretable yield [3]	(1,920)
Fair value of loans acquired	$ 3,070

(1) Amount represents principal and interest payments, both currently due and due in the future, adjusted for the effect of estimated prepayments.
(2) Charge-offs on acquired loans will be written off against non-accretable difference.
(3) Amount accreted into interest income over the estimated lives of the acquired loans.

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The following table shows contractually required payments receivable, cash flows expected to be collected and fair value of the additional private student loans acquired from Citibank for the loans acquired as of September 30, 2011 (dollars in millions):

	At September 30, 2011
Contractually required payments receivable [(1)]	$3,861
Less: Non-accretable difference [(2)]	(573)
Cash flows expected to be collected	3,288
Less: Accretable yield [(3)]	(855)
Fair value of loans acquired	$2,433

(1) Amount represents principal and interest payments, both currently due and due in the future, adjusted for the effect of estimated prepayments.
(2) Charge-offs on acquired loans will be written off against non-accretable difference.
(3) Amount to be accreted into interest income over the estimated lives of the acquired loans.

The following table provides changes in accretable yield for the acquired loans for the three and nine month periods ended August 31, 2012 and 2011 (dollars in millions):

	For the Three Months Ended August 31,		For the Nine Months Ended August 31,	
	2012	2011	2012	2011
Balance at beginning of period	$2,313	$1,772	$2,580	$—
Acquisition of The Student Loan Corporation	—	—	—	1,776
Accretion into interest income	(75)	(54)	(229)	(149)
Other changes in expected cash flows	(13)	—	(126)	91
Balance at end of period	$2,225	$1,718	$2,225	$1,718

During the three and nine months ended August 31, 2012, the Company adjusted accretable yield by $13 million and $126 million, respectively, because of a decrease in expected cash flows. These decreases related primarily to changes in borrower prepayments, and were not a result of credit deterioration. During the nine months ended August 31, 2011, the Company adjusted accretable yield by $91 million because of an increase in expected cash flows based on a change in prepayment assumptions. These amounts will be recognized prospectively as an adjustment to yield over the remaining life of the pools.

At August 31, 2012, the 30 or more days delinquency and 90 or more days delinquency rates on PCI student loans (which includes loans not yet in repayment) were 2.63% and 0.69%, respectively. At August 31, 2011, the 30 or more days delinquency and 90 or more days delinquency rates on PCI student loans (which includes loans not yet in repayment) were 2.60% and 0.83%, respectively. These rates include private student loans that are greater than 120 days delinquent that are covered by an indemnification agreement or insurance arrangements through which the Company expects to recover a substantial portion of the loan. The net charge-off rate on PCI student loans for the three and nine months ended August 31, 2012 was 1.13% and 1.32%, respectively. The net charge-off rate on PCI student loans for the three and nine months ended August 31, 2011 was 1.23% and 1.22%, respectively.

Mortgage loans held for sale. The Company originates all of its residential real estate loans with the intent to sell them in the secondary market. Loans held for sale consist primarily of residential first mortgage loans that are secured by residential real estate throughout the United States. Mortgage loans are funded through a warehouse line of credit and are recorded at fair value. Changes in the fair value of mortgage loans are recorded through revenue prior to the sale of the loans to investors. The gain or loss on the sale of loans is recognized on the date the loans are sold and is based on the difference between the sale proceeds received and the fair value of the loans, adjusted for the impact of the related hedges (see Note 15: Derivatives and Hedging Activities for further discussion of the mortgage loan related hedging activities). The Company sells its loans on a servicing released basis in which the Company gives up the right to service the loans.

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The following table provides a summary of the initial unpaid principal balance of mortgage loans sold by type of loan for the quarter ended August 31, 2012 (dollars in millions):

	For the Three Months Ended August 31, 2012		
	Amount	%	
Conforming[(1)]	$396.5	75.09	%
FHA[(2)]	131.5	24.91	%
Total	$528.0	100.00	%

(1) Conforming loans are loans that conform to Government Sponsored Enterprises guidelines.
(2) FHA loans are loans that are insured by the Federal Housing Administration typically for borrowers with low down payments and loan amounts meeting certain limits.

The following table represents the loans held for sale by type of loan as of August 31, 2012 (dollars in thousands):

	At August 31, 2012		
	Amount	%	
Conforming[(1)]	$183,666	67.50	%
FHA[(2)]	88,416	32.50	%
Total	$272,082	100.00	%

(1) Conforming loans are loans that conform to Government Sponsored Enterprises guidelines.
(2) FHA loans are loans that are insured by the Federal Housing Administration typically for borrowers with low down payments and loan amounts meeting certain limits.

5. Credit Card and Student Loan Securitization Activities

Credit Card Securitization Activities

The Company accesses the term asset securitization market through the Discover Card Master Trust I (“DCMT”) and the Discover Card Execution Note Trust (“DCENT”), which are trusts into which credit card loan receivables are transferred (or, in the case of DCENT, into which beneficial interests in DCMT are transferred) and from which beneficial interests are issued to investors.

The DCMT structure consists of Class A, triple-A rated certificates and Class B, single-A rated certificates held by third parties. Credit enhancement is provided by the subordinated Class B certificates, cash collateral accounts, and more subordinated Series 2009-CE certificates that are held by a wholly-owned subsidiary of Discover Bank. The DCENT debt structure consists of four classes of securities (DiscoverSeries Class A, B, C and D notes), with the most senior class generally receiving a triple-A rating. In this structure, in order to issue senior, higher rated classes of notes, it is necessary to obtain the appropriate amount of credit enhancement, generally through the issuance of junior, lower rated or more highly subordinated classes of notes. The majority of these more highly subordinated classes of notes are held by subsidiaries of Discover Bank. In addition, during the nine months ended August 31, 2012, there was another outstanding series of certificates (Series 2009-SD), issued by DCMT, that provided increased excess spread levels to all other outstanding securities of the trusts. The Series 2009-SD certificates were held by a wholly-owned subsidiary of Discover Bank. The Series 2009-SD balance of $346.4 million matured on January 17, 2012, automatically triggering a higher required level of the Class D (2009-1) note. Accordingly, the size of the Class D (2009-1) note was increased by $241.7 million. The credit-related risk of loss associated with trust assets as of the balance sheet date to which the Company is exposed through the retention of these subordinated interests is fully captured in the allowance for loan losses recorded by the Company.

The Company’s credit card securitizations are accounted for as secured borrowings and the trusts are treated as consolidated subsidiaries of the Company. The Company’s retained interests in the assets of the trusts, principally consisting of investments in DCMT certificates and DCENT notes held by subsidiaries of Discover Bank, constitute intercompany positions which are eliminated in the preparation of the Company’s consolidated statement of financial condition.

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Upon transfer of credit card loan receivables to the trust, the receivables and certain cash flows derived from them become restricted for use in meeting obligations to the trusts' creditors. The trusts have ownership of cash balances that also have restrictions, the amounts of which are reported in restricted cash. Investment of trust cash balances is limited to investments that are permitted under the governing documents of the trusts and which have maturities no later than the related date on which funds must be made available for distribution to trust investors. With the exception of the seller's interest in trust receivables, the Company's interests in trust assets are generally subordinate to the interests of third-party investors and, as such, may not be realized by the Company if needed to absorb deficiencies in cash flows that are allocated to the investors in the trusts' debt. The carrying values of these restricted assets, which are presented on the Company's condensed consolidated statement of financial condition as relating to securitization activities, are shown in the table below (dollars in thousands):

	August 31, 2012	November 30, 2011
Cash collateral accounts	$147,632	$187,105
Collections and interest funding accounts	63,140	977,195
Restricted cash	210,772	1,164,300
Investors' interests held by third-party investors	15,068,423	13,294,739
Investors' interests held by wholly owned subsidiaries of Discover Bank	4,805,402	5,157,536
Seller's interest	13,643,757	15,363,585
Loan receivables [(1)]	33,517,582	33,815,860
Allowance for loan losses allocated to securitized loan receivables [(1)]	(1,074,058)	(1,510,730)
Net loan receivables	32,443,524	32,305,130
Other	33,123	26,506
Carrying value of assets of consolidated variable interest entities	$32,687,419	$33,495,936

(1) The Company maintains its allowance for loan losses at an amount sufficient to absorb probable losses inherent in all loan receivables, which includes all loan receivables in the trusts. Therefore, credit risk associated with the transferred receivables is fully reflected on the Company's balance sheet in accordance with GAAP.

The debt securities issued by the consolidated VIEs are subject to credit, payment and interest rate risks on the transferred credit card loan receivables. To protect investors, the securitization structures include certain features that could result in earlier-than-expected repayment of the securities. The primary investor protection feature relates to the availability and adequacy of cash flows in the securitized pool of receivables to meet contractual requirements. Insufficient cash flows would trigger the early repayment of the securities. This is referred to as the "economic early amortization" feature.

Investors are allocated cash flows derived from activities related to the accounts comprising the securitized pool of receivables, the amounts of which reflect finance charges billed, certain fee assessments, allocations of merchant discount and interchange, and recoveries on charged-off accounts. From these cash flows, investors are reimbursed for charge-offs occurring within the securitized pool of receivables and receive a contractual rate of return and Discover Bank is paid a servicing fee as servicer. Any cash flows remaining in excess of these requirements are reported to investors as excess spread. An excess spread rate of less than 0% for a contractually specified period, generally a three-month average, would trigger an economic early amortization event. In such an event, the Company would be required to seek immediate sources of replacement funding. Apart from the restricted assets related to securitization activities, the investors and the securitization trusts have no recourse to the Company's other assets or the Company's general credit for a shortage in cash flows.

The Company is required to maintain a contractual minimum level of receivables in the trust in excess of the face value of outstanding investors' interests. This excess is referred to as the minimum seller's interest requirement. The required minimum seller's interest in the pool of trust receivables, which is included in credit card loan receivables restricted for securitization investors, is set at approximately 7% in excess of the total investors' interests (which includes interests held by third parties as well as those certificated interests held by the Company). If the level of receivables in the trust was to fall below the required minimum, the Company would be required to add receivables from the unrestricted pool of receivables, which would increase the amount of credit card loan receivables restricted for securitization investors. A decline in the amount of the excess seller’s interest could occur if balance repayments and charge-offs exceeded new lending on the securitized accounts or as a result of changes in total outstanding investors’ interests. If the Company could not add enough receivables to satisfy the requirement, an early amortization (or repayment) of investors’ interests would be triggered. We retain significant exposure to the performance of trust assets through holdings of the seller's interest and subordinated security classes of DCMT and DCENT.

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Another feature of the Company's credit card securitization structure that is designed to protect investors' interests from loss, which is applicable only to the notes issued from DCENT, is a reserve account funding requirement in which excess cash flows generated by the transferred loan receivables are held at the trust. This funding requirement is triggered when DCENT's three-month average excess spread rate decreases to below 4.5%, with increasing funding requirements as excess spread levels decline below preset levels to 0%.

In addition to performance measures associated with the transferred credit card loan receivables or the inability to add receivable to satisfy the seller's interest requirement, there are other events or conditions which could trigger an early amortization event., such as non-payment of principal at expected maturity. As of August 31, 2012, no economic or other early amortization events have occurred.

The tables below provide information concerning investors' interests and related excess spreads at August 31, 2012 (dollars in thousands):

	Investors' Interests[(1)]	# of Series Outstanding
Discover Card Master Trust I	$2,288,598	4
Discover Card Execution Note Trust (DiscoverSeries notes)	17,585,227	37
Total investors' interests	$19,873,825	41

(1) Investors' interests include third-party interests and subordinated interests held by wholly-owned subsidiaries of Discover Bank.

	3-Month Rolling Average Excess Spread[(1)]	
Group excess spread percentage	13.41	%
DiscoverSeries excess spread percentage	13.32	%

(1) DCMT certificates refer to the higher of the Group excess spread or their applicable series excess spread (not shown) and DiscoverSeries notes refer to the higher of the Group or DiscoverSeries excess spread in assessing whether an economic early amortization has been triggered.

The Company continues to own and service the accounts that generate the loan receivables held by the trusts. Discover Bank receives servicing fees from the trusts based on a percentage of the monthly investor principal balance outstanding. Although the fee income to Discover Bank offsets the fee expense to the trusts and thus is eliminated in consolidation, failure to service the transferred loan receivables in accordance with contractual requirements could lead to a termination of the servicing rights and the loss of future servicing income, net of related expenses.

Student Loan Securitization Activities

The Company's student loan securitizations are accounted for as secured borrowings and the trusts are treated as consolidated subsidiaries of the Company. Trust receivables underlying third-party investors' interests are recorded in purchased credit-impaired loans, and the related debt issued by the trusts is reported in long-term borrowings. The assets of the Company's consolidated VIEs are restricted from being sold or pledged as collateral for other borrowings and the cash flows from these restricted assets may be used only to pay obligations of the trust.

Currently there are three trusts from which securities were issued to investors. Principal payments on the long-term secured borrowings are made as cash is collected on the underlying loans that are used as collateral on the secured borrowings. The Company does not have access to cash collected by the securitization trusts until cash is released in accordance with the trust indenture agreements and, for certain securitizations, no cash will be released to the Company until all outstanding trust borrowings have been repaid. Similar to the credit card securitizations, the Company continues to own and service the accounts that generate the student loan receivables held by the trusts and receives servicing fees from the trusts based on either a percentage of the principal balance outstanding or a flat fee per borrower. Although the servicing fee income offsets the fee expense related to the trusts, failure to service the transferred loan receivables in accordance with contractual requirements could lead to a termination of the servicing rights and the loss of future servicing income.

Under terms of all the trust arrangements, the Company has the option, but not the obligation, to provide financial support to the trusts, but has never provided such support. A substantial portion of the credit risk associated with the securitized loans has been transferred to third parties under private credit insurance or indemnification arrangements. See Note 2: Business Combinations.

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The carrying values of these restricted assets, which are presented on the Company's condensed consolidated statement of financial condition as relating to securitization activities, are shown in the table below (dollars in thousands):

	August 31, 2012	November 30, 2011
Restricted cash	$84,667	$109,875
Student loan receivables	2,631,970	2,839,871
Other assets	515	7,218
Carrying value of assets of consolidated variable interest entities	$2,717,152	$2,956,964

6. Deposits

The Company offers its deposit products, including certificates of deposit, money market accounts, online savings accounts and Individual Retirement Account (IRA) certificates of deposit to customers through two channels: (i) directly through marketing, internet origination and affinity relationships ("direct-to-consumer deposits"); and (ii) indirectly through contractual arrangements with securities brokerage firms ("brokered deposits"). As of August 31, 2012 and November 30, 2011, the Company had approximately $27.7 billion and $26.2 billion, respectively, of direct-to-consumer deposits and approximately $14.5 billion and $13.3 billion, respectively, of brokered deposits.

A summary of interest-bearing deposit accounts is as follows (dollars in thousands):

	August 31, 2012	November 30, 2011
Certificates of deposit in amounts less than $100,000[1]	$21,301,782	$20,114,121
Certificates of deposit from amounts of $100,000[1] to less than $250,000[1]	5,352,917	5,290,405
Certificates of deposit in amounts of $250,000[1] or greater	1,216,105	1,189,779
Savings deposits, including money market deposit accounts	14,304,228	12,869,582
Total interest-bearing deposits	$42,175,032	$39,463,887
Average annual interest rate	2.00 %	2.57 %

(1) $100,000 represents the basic insurance amount previously covered by the FDIC. Effective July 21, 2010, the basic insurance per depositor was permanently increased to $250,000.

At August 31, 2012, certificates of deposit maturing during the remainder of 2012, over each of the next four years, and thereafter were as follows (dollars in thousands):

Year	Amount
2012	$3,367,953
2013	$11,499,477
2014	$5,454,427
2015	$3,292,971
2016	$1,825,914
Thereafter	$2,430,062

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7. Borrowings

Long-term borrowings consist of borrowings and capital leases having original maturities of one year or more. The following table provides a summary of the Company’s long-term borrowings and weighted average interest rates on balances outstanding at period end (dollars in thousands):

	August 31, 2012			November 30, 2011				
	Outstanding	Interest Rate		Outstanding	Interest Rate		Interest Rate Terms	Maturity
Securitized Debt								
Fixed rate asset-backed securities								
Principal value (including discount of $1,344)	$4,548,656	2.87	%	$1,748,742	5.65	%	Various fixed rates	Various June 2013—July 2019
Fair value adjustment(1)	7,965			—				
Book value	4,556,621			1,748,742				
Floating rate asset-backed securities	9,018,423	0.51	%	10,044,739	0.81	%	1-month LIBOR(2) + 8 to 65 basis points	Various December 2012—May 2017
Floating rate asset-backed securities	1,250,000							