Discover Financial Services
Form 10-Q
April 30, 2013

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 March 31, 2013

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 April 26, 2013, there were 490,424,845 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 March 31, 2013
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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 Cashback Checking℠, Discover® More® Card, Discover it™, 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

	March 31, 2013 (unaudited)	December 31, 2012	November 30, 2012
	(dollars in millions, except share amounts)		
Assets			
Cash and cash equivalents	$8,067	$ 2,584	$ 3,926
Restricted cash	482	290	2,344
Investment securities:			
Available-for-sale (amortized cost of $5,098, $6,031 and $6,015 at March 31, 2013, December 31, 2012 and November 30, 2012, respectively)	5,196	6,145	6,133
Held-to-maturity (fair value of $76, $89 and $90 at March 31, 2013, December 31, 2012 and November 30, 2012, respectively)	74	87	88
Total investment securities	5,270	6,232	6,221
Loan receivables:			
Mortgage loans held for sale, measured at fair value	311	355	322
Loan portfolio:			
Credit card	48,655	51,135	49,642
Other	6,857	6,406	6,309
Purchased credit-impaired loans	4,561	4,702	4,744
Total loan portfolio	60,073	62,243	60,695
Total loan receivables	60,384	62,598	61,017
Allowance for loan losses	(1,634)	(1,788)	(1,725)
Net loan receivables	58,750	60,810	59,292
Premises and equipment, net	572	538	534
Goodwill	286	286	286
Intangible assets, net	187	189	190
Other assets	2,525	2,562	2,490
Total assets	$76,139	$ 73,491	$ 75,283
Liabilities and Stockholders' Equity			
Deposits:			
Interest-bearing deposit accounts	$42,255	$ 42,077	$ 42,034
Non-interest bearing deposit accounts	139	136	121
Total deposits	42,394	42,213	42,155
Short-term borrowings	290	327	284
Long-term borrowings	19,230	17,666	19,729
Accrued expenses and other liabilities	3,926	3,412	3,337
Total liabilities	65,840	63,618	65,505
Commitments, contingencies and guarantees (Notes 9, 12, and 13)			
Stockholders' Equity:			
Common stock, par value $0.01 per share; 2,000,000,000 shares authorized; 554,855,707, 553,350,975 and 553,049,298 shares issued at March 31, 2013, December 31, 2012 and November 30, 2012, respectively	6	5	5
Preferred stock, par value $0.01 per share; 200,000,000 shares authorized; 575,000 shares issued or outstanding and aggregate liquidation preference of	560	560	560

$575 at March 31, 2013, December 31, 2012 and November 30, 2012, respectively			
Additional paid-in capital	3,632	3,598	3,593
Retained earnings	8,136	7,472	7,373
Accumulated other comprehensive loss	(84)	(72)	(75)
Treasury stock, at cost; 62,008,845, 55,489,104 and 55,177,937 shares at March 31, 2013, December 31, 2012 and November 30, 2012, respectively	(1,951)	(1,690)	(1,678)
Total stockholders' equity	10,299	9,873	9,778
Total liabilities and stockholders' equity	$76,139	$ 73,491	$ 75,283

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.

	March 31, 2013	December 31, 2012	November 30, 2012
	(unaudited)	(dollars in millions)	
Assets			
Restricted cash	$474	$ 280	$ 2,337
Credit card loan receivables	32,630	34,782	33,764
Purchased credit-impaired loans	2,461	2,539	2,563
Allowance for loan losses allocated to securitized loan receivables	(988)	(1,110)	(1,069)
Other assets	31	29	30
Liabilities			
Long-term borrowings	$16,744	$ 15,933	$ 17,995
Accrued interest payable	11	11	13

See Notes to Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Income

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
	(unaudited)		
	(dollars in millions, except per share amounts)		
Interest income:			
Credit card loans	$1,451	$1,414	$510
Other loans	234	205	78
Investment securities	20	18	7
Other interest income	3	4	—
Total interest income	1,708	1,641	595
Interest expense:			
Deposits	186	224	65
Short-term borrowings	1	—	—
Long-term borrowings	111	125	38
Total interest expense	298	349	103
Net interest income	1,410	1,292	492
Provision for loan losses	159	84	178
Net interest income after provision for loan losses	1,251	1,208	314
Other income:			
Discount and interchange revenue, net	263	240	82
Protection products revenue	88	103	33
Loan fee income	81	81	29
Transaction processing revenue	53	49	18
Gain on investments	3	—	2
Gain on origination and sale of mortgage loans	51	—	17
Other income	43	38	19
Total other income	582	511	200
Other expense:			
Employee compensation and benefits	290	246	87
Marketing and business development	169	128	51
Information processing and communications	78	72	25
Professional fees	104	104	34
Premises and equipment	19	18	8
Other expense	93	104	35
Total other expense	753	672	240
Income before income tax expense	1,080	1,047	274
Income tax expense	407	397	104
Net income	$673	$650	$170
Net income allocated to common stockholders	$659	$644	$168
Basic earnings per share	$1.33	$1.22	$0.34
Diluted earnings per share	$1.33	$1.21	$0.34
Dividends declared per share	$—	$0.10	$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 March 31,		For the One Month Ended December 31,
	2013	2012	2012
	(unaudited) (dollars in millions)		
Net income	$673	$650	$170
Other comprehensive (loss) income, net of taxes			
Unrealized loss on securities available for sale, net of tax	(11)	(8)	(3)
Unrealized loss on cash flow hedges, net of tax	(1)	(2)	—
Unrealized pension and post-retirement plan gain, net of tax	—	1	6
Other comprehensive (loss) income	(12)	(9)	3
Comprehensive income	$661	$641	$173

See Notes to the Condensed Consolidated Financial Statements.

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

	Preferred Stock		Common Stock						
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders’ Equity
	(unaudited) (dollars in millions, shares in thousands)								
Balance at December 31, 2011	—	$—	549,958	$ 5	$ 3,515	$ 5,351	$ (49)	$ (464)	$ 8,358
Net income	—	—	—	—	—	650	—	—	650
Other comprehensive loss	—	—	—	—	—	—	(9)	—	(9)
Purchases of treasury stock [1]	—	—	—	—	(250)	—	—	(20)	(270)
Common stock issued under employee benefit plans	—	—	15	—	—	—	—	—	—
Common stock issued and stock-based compensation expense	—	—	2,069	—	25	—	—	—	25
Dividends declared—common stock	—	—	—	—	—	(51)	—	—	(51)
Balance at March 31, 2012	—	$—	552,042	$ 5	$ 3,290	$ 5,950	$ (58)	$ (484)	$ 8,703
Balance at November 30, 2012	575	$ 560	553,049	$ 5	$ 3,593	$ 7,373	$ (75)	$ (1,678)	$ 9,778
Net income	—	—	—	—	—	170	—	—	170
Other comprehensive income	—	—	—	—	—	—	3	—	3
Purchases of treasury stock	—	—	—	—	—	—	—	(12)	(12)
Common stock issued and stock-based compensation expense	—	—	302	—	5	—	—	—	5
Dividends declared—common and Series B preferred stock	—	—	—	—	—	(71)	—	—	(71)
Balance at December 31, 2012	575	$ 560	553,351	$ 5	$ 3,598	$ 7,472	$ (72)	$ (1,690)	$ 9,873
Net income	—	—	—	—	—	673	—	—	673
Other comprehensive loss	—	—	—	—	—	—	(12)	—	(12)
Purchases of treasury stock	—	—	—	—	—	—	—	(261)	(261)
	—	—	15	—	1	—	—	—	1

Common stock issued under employee benefit plans									
Common stock issued and stock-based compensation expense	—	—	1,490	1	33	—	—	—	34
Dividends declared — Series B preferred stock	—	—	—	—	—	(9)	—	—	(9)
Balance at March 31, 2013	575	$560	554,856	$6	$3,632	$8,136	$(84)	$(1,951)	$10,299

(1) During first quarter 2012, the Company executed an accelerated share repurchase agreement with an unaffiliated financial institution to purchase $250 million of outstanding shares of common stock. This transaction was not settled as of March 31, 2012 and was therefore reported as a reduction of additional paid-in capital.

See Notes to the Condensed Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Cash Flows

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
	(unaudited) (dollars in millions)		
Cash flows from operating activities			
Net income	$673	$650	$170
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	159	84	178
Deferred income taxes	121	108	(12)
Depreciation and amortization on premises and equipment	25	23	9
Amortization of deferred revenues	(48)	(50)	(16)
Other depreciation and amortization	43	38	15
Accretion of accretable yield on acquired loans	(70)	(77)	(24)
Gain on investments	(3)	—	(2)
Loss on equity method and other investments	4	2	1
(Gain) loss on origination and sale of loans	(51)	1	(17)
Stock-based compensation expense	17	10	3
Proceeds from sale of mortgage loans originated for sale	1,249	—	378
Net principal disbursed on mortgage loans originated for sale	(1,156)	—	(392)
Changes in assets and liabilities:			
Increase in other assets	(88)	(16)	(68)
Increase (decrease) in accrued expenses and other liabilities	617	(68)	(1)
Net cash provided by operating activities	1,492	705	222
Cash flows from investing activities			
Maturities and sales of available-for-sale investment securities	1,015	440	112
Purchases of available-for-sale investment securities	(90)	(679)	(132)
Maturities of held-to-maturity investment securities	13	2	1
Proceeds from sale of student loans held for sale	—	268	—
Net principal disbursed on loans originated for investment	2,102	2,005	(1,599)
Purchases of loan receivables	(133)	(211)	(27)
Purchases of other investments	(31)	(8)	(4)
Proceeds from sale of other investments	—	—	17
(Increase) decrease in restricted cash	(192)	(483)	2,054
Purchases of premises and equipment	(59)	(31)	(13)
Net cash provided by investing activities	2,625	1,303	409
Cash flows from financing activities			
Net (decrease) increase in short-term borrowings	(37)	—	43
Proceeds from issuance of securitized debt	1,700	999	—
Maturities and repayment of securitized debt	(899)	(108)	(2,066)
Proceeds from issuance of other long-term borrowings	750	—	—
Repayment of long-term borrowings and bank notes	—	(5)	—
Proceeds from issuance of common stock	5	10	2

Purchases of treasury stock	(261)	(270)	(12)
Net increase in deposits	187	970	65
Dividends paid on common and preferred stock	(79)	(53)	(5)
Net cash provided by (used for) financing activities	1,366	1,543	(1,973)
Net increase (decrease) in cash and cash equivalents	5,483	3,551	(1,342)
Cash and cash equivalents, at beginning of period	2,584	2,335	3,926
Cash and cash equivalents, at end of period	$8,067	$5,886	$2,584
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Interest expense	$231	$303	$81
Income taxes, net of income tax refunds	$113	$378	$(1)
Non-cash investing and financing transactions:			
Assumption of debt by buyer related to loans sold	$—	$425	$—

See Notes to the Condensed Consolidated Financial Statements.

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. 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 network partner 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 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 private student loans, personal loans, home loans, prepaid cards and other consumer lending and deposit products. The majority of Direct Banking revenues relate to interest income earned on its loan products. The Payment Services segment includes PULSE, Diners Club and the Company's network partners business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties. The majority of Payment Services revenues relate to transaction processing revenue from PULSE and royalty and licensee revenue from Diners Club.

Change in Fiscal Year End. On December 3, 2012, the Company's board of directors approved a change in the Company's fiscal year end from November 30 to December 31 of each year. This fiscal year change was effective January 1, 2013. As a result of the change, the Company had a one month transition period in December 2012. The unaudited results for the one month ended December 31, 2012 and 2011 are included in this report. The audited results for the one month ended December 31, 2012 and the unaudited results for the one month ended December 31, 2011 will be included in the Company's annual report on Form 10-K for the year ending December 31, 2013. For further information regarding the one month as of and ended December 31, 2012 and the one month as of and ended December 31, 2011, see Note 17: Transition Period Financial Information herein. In addition, the results for the quarter ended March 31, 2013 are compared with the results of the quarter ended March 31, 2012, which have been recast on a calendar basis due to the change in the Company's fiscal year.

As a result of the fiscal year change, the quarterly dividend declaration dates were also changed to coincide with the calendar year reporting periods. As a result, a dividend was declared during the one month ended December 31, 2012 and no dividend was declared during the three months ended March 31, 2013.

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 2012 audited consolidated financial statements filed with the Company’s annual report on Form 10-K for the fiscal year ended November 30, 2012. Beginning with the 2012 Form 10-K, the Company began reporting all dollar amounts in millions. In certain circumstances, this change in rounding resulted in prior year disclosures being removed.
Recently Issued Accounting Pronouncements. In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ("ASU") No. 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in the consolidated statements of income if the amount being reclassified is required to be reclassified in its entirety to net income. For amounts that are not required to be reclassified to net income in their entirety in the same reporting period, an entity is required to cross-reference other disclosures that provide additional detail about those amounts. The new reporting requirements do not change the way in which net income or comprehensive income is derived. The new standard applies to both interim and annual financial statements and is effective for the Company beginning with this filing. Because this amendment impacted disclosures only, the adoption of this ASU had no effect on the Company's financial condition, results of operations or cash flows.
In July 2012, the FASB issued 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. Because this standard impacts the impairment analysis only, it will have no effect on the Company's financial condition, results of operations or cash flows.
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. This ASU is effective for the Company with this filing. Because this amendment impacted disclosures only, the adoption of this ASU had no effect on the Company's financial condition, results of operations or cash flows.

2. Business Combinations

Acquisition of the net assets of 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 $49 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 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 million of purchase price will be due from the Company on the first anniversary of the closing, subject to certain conditions being satisfied. Since the acquisition date, the results of operations and cash flows of Home Loan Center have been included in the Company's consolidated results of operations and cash flows.

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3. Investments

The Company’s investment securities consist of the following (dollars in millions):

	March 31, 2013	December 31, 2012	November 30, 2012
U.S. Treasury securities	$2,082	$2,460	$2,463
U.S. government agency securities	1,704	2,233	2,237
States and political subdivisions of states	24	34	34
Other securities:			
Credit card asset-backed securities of other issuers	108	151	159
Corporate debt securities (1)	—	—	75
Residential mortgage-backed securities - Agency (2)	1,352	1,354	1,253
Total other securities	1,460	1,505	1,487
Total investment securities	$5,270	$6,232	$6,221

(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 millions):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At March 31, 2013				
Available-for-Sale Investment Securities [1]				
U.S. Treasury securities	$2,039	$42	$—	$2,081
U.S. government agency securities	1,663	41	—	1,704
Credit card asset-backed securities of other issuers	107	1	—	108
Residential mortgage-backed securities - Agency	1,289	14	—	1,303
Total available-for-sale investment securities	$5,098	$98	$—	$5,196
Held-to-Maturity Investment Securities [2]				
U.S. Treasury securities [3]	$1	$—	$—	$1
States and political subdivisions of states	24	—	—	24
Residential mortgage-backed securities - Agency [4]	49	2	—	51
Total held-to-maturity investment securities	$74	$2	$—	$76
At December 31, 2012				
Available-for-Sale Investment Securities [1]				
U.S. Treasury securities	$2,413	$46	$—	$2,459
U.S. government agency securities	2,187	46	—	2,233
Credit card asset-backed securities of other issuers	149	2	—	151
Residential mortgage-backed securities - Agency	1,282	20	—	1,302
Total available-for-sale investment securities	$6,031	$114	$—	$6,145
Held-to-Maturity Investment Securities [2]				
U.S. Treasury securities [3]	$1	$—	$—	$1
States and political subdivisions of states	34	—	—	34
Residential mortgage-backed securities - Agency [4]	52	2	—	54
Total held-to-maturity investment securities	$87	$2	$—	$89

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At November 30, 2012				
Available-for-Sale Investment Securities [1]				
U.S. Treasury securities	$2,414	$48	$—	$2,462
U.S. government agency securities	2,189	48	—	2,237
Credit card asset-backed securities of other issuers	157	2	—	159
Corporate debt securities	75	—	—	75
Residential mortgage-backed securities - Agency	1,180	20	—	1,200
Total available-for-sale investment securities	$6,015	$118	$—	$6,133
Held-to-Maturity Investment Securities [2]				
U.S. Treasury securities [3]	$1	$—	$—	$1
States and political subdivisions of states	34	—	—	34
Residential mortgage-backed securities - Agency [4]	53	2	—	55
Total held-to-maturity investment securities	$88	$2	$—	$90

(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.

During the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012, the Company received $309 million, $442 million, and $113 million, respectively, of proceeds related to maturities, redemptions, or liquidation of investment securities. For the three months ended March 31, 2013, these proceeds primarily resulted from $100 million maturities of U.S. government agency securities, $82 million maturities of residential mortgage-backed securities, and $75 million maturities of U.S. Treasury securities. For the three months ended March 31, 2012, these proceeds primarily resulted from $200 million maturities of U.S. Treasury securities, $140 million maturities of U.S. government agency securities, and $75 million maturities of corporate debt securities. For the one month ended December 31, 2012, $75 million of these proceeds related to maturities of corporate debt securities.

The Company records gains and losses on investment securities in other income when investments are sold or liquidated, when the Company believes an investment is other than temporarily impaired prior to the disposal of the investment, or in certain other circumstances. Proceeds from the sales of available-for-sale investment securities, which were comprised of U.S. Treasury securities and U.S. government agency securities, were $719 million during the three months ended March 31, 2013. The Company recognized gains on investments of $3 million which were recorded entirely in earnings. These gains were driven primarily by gains on sales of available-for-sale investment securities of $2 million which were calculated using the specific identification method. There were no gains or losses related to sales of investment securities during the three months ended March 31, 2012 or during the one month ended December 31, 2012. There were no gains or losses related to other than temporary impairments during the three months ended March 31, 2013, 2012 or during the one month ended December 31, 2012.

The Company records unrealized gains and losses on its available-for-sale investment securities in other comprehensive income. For the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012, the Company recorded net unrealized losses of $16 million, $12 million, and $5 million ($11 million, $8 million, and $3 million after tax), respectively, in other comprehensive income.

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Maturities of available-for-sale debt securities and held-to-maturity debt securities at March 31, 2013 are provided in the table below (dollars in millions):

	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	$197	$1,842	$—	$—	$2,039
U.S. government agency securities	120	1,543	—	—	1,663
Credit card asset-backed securities of other issuers	107	—	—	—	107
Residential mortgage-backed securities - Agency	—	—	377	912	1,289
Total available-for-sale investment securities	$424	$3,385	$377	$912	$5,098
Held-to-maturity—Amortized Cost[2]					
U.S. Treasury securities	$1	$—	$—	$—	$1
State and political subdivisions of states	1	1	—	22	24
Residential mortgage-backed securities - Agency[3]	—	—	—	49	49
Total held-to-maturity investment securities	$2	$1	$—	$71	$74
Available-for-sale—Fair Values[1]					
U.S. Treasury securities	$198	$1,883	$—	$—	$2,081
U.S. government agency securities	120	1,584	—	—	1,704
Credit card asset-backed securities of other issuers	108	—	—	—	108
Residential mortgage-backed securities - Agency	—	—	381	922	1,303
Total available-for-sale investment securities	$426	$3,467	$381	$922	$5,196
Held-to-maturity—Fair Values[2]					
U.S. Treasury securities	$1	$—	$—	$—	$1
State and political subdivisions of states	1	1	—	22	24
Residential mortgage-backed securities - Agency[3]	—	—	—	51	51
Total held-to-maturity investment securities	$2	$1	$—	$73	$76

(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 March 31, 2013, December 31, 2012 and November 30, 2012, the Company had outstanding investments of $262 million, $259 million, and $235 million respectively, in these entities, and the related contingent liability was $65 million, $79 million, and $59 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 Student Loan Corporation ("SLC") transaction and in a separate portfolio acquisition. Within these portfolio segments, the Company has classes of receivables which are depicted in the table below (dollars in millions):

	March 31, 2013	December 31, 2012	November 30, 2012
Mortgage loans held for sale [(1)]	$311	$355	$322
Loan portfolio:			
Credit card loans:			
Discover card [(2)]	48,451	50,929	49,436
Discover business card	204	206	206
Total credit card loans	48,655	51,135	49,642
Other loans:			
Personal loans	3,395	3,296	3,272
Private student loans	3,426	3,072	3,000
Other	36	38	37
Total other loans	6,857	6,406	6,309
PCI student loans [(3)]	4,561	4,702	4,744
Total loan portfolio	60,073	62,243	60,695
Total loan receivables	60,384	62,598	61,017
Allowance for loan losses	(1,634)	(1,788)	(1,725)
Net loan receivables	$58,750	$60,810	$59,292

(1) Substantially all mortgage loans held for sale are pledged as collateral against the warehouse line of credit used to fund consumer residential loans.

(2) Amounts include $19.5 billion, $18.8 billion and $21.0 billion underlying investors' interest in trust debt at March 31, 2013, December 31, 2012 and November 30, 2012, respectively, and $13.1 billion, $16.0 billion and $12.7 billion in seller's interest at March 31, 2013, December 31, 2012 and November 30, 2012, respectively. See Note 5: Credit Card and Student Loan Securitization Activities for further information.

(3) Amounts include $2.5 billion, $2.5 billion and $2.6 billion of loans pledged as collateral against the notes issued from the SLC securitization trusts at March 31, 2013, December 31, 2012 and November 30, 2012, respectively. See Note 5: Credit Card and Student Loan Securitization Activities. Of the remaining $2.1 billion, $2.2 billion and $2.1 billion at March 31, 2013, December 31, 2012 and November 30, 2012, respectively, that were not pledged as collateral, approximately $18 million, $17 million and $16 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.

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, credit card and closed-end consumer 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 millions):

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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[(1)]
At March 31, 2013					
Credit card loans:					
Discover card [(2)]	$418	$440	$858	$388	$ 188
Discover business card	2	2	4	2	1
Total credit card loans	420	442	862	390	189
Other loans:					
Personal loans [(3)]	19	7	26	7	5
Private student loans (excluding PCI) [(4)]	32	19	51	14	5
Other	—	1	1	—	1
Total other loans (excluding PCI)	51	27	78	21	11
Total loan receivables (excluding PCI)	471	469	940	411	200
At December 31, 2012					
Credit card loans:					
Discover card [(2)]	$455	$458	$913	$407	$ 183
Discover business card	2	2	4	2	1
Total credit card loans	457	460	917	409	184
Other loans:					
Personal loans [(3)]	18	8	26	7	4
Private student loans (excluding PCI) [(4)]	28	9	37	7	2
Other	—	1	1	—	2
Total other loans (excluding PCI)	46	18	64	14	8
Total loan receivables (excluding PCI)	503	478	981	423	192
At November 30, 2012					
Credit card loans:					
Discover card [(2)]	$472	$449	$921	$398	$ 189
Discover business card	2	2	4	2	1
Total credit card loans	474	451	925	400	190
Other loans:					
Personal loans [(3)]	17	8	25	7	4
Private student loans (excluding PCI) [(4)]	24	8	32	6	2
Other	—	1	1	—	2
Total other loans (excluding PCI)	41	17	58	13	8
Total loan receivables (excluding PCI)	515	468	983	413	198

(1) 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 $8 million, $8 million and $3 million for the three months ended March 31, 2013 and 2012 and the one month ended December 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. This amount was estimated based on customers' current balances and most recent rates.

(2)

Consumer credit card loans that are 90 or more days delinquent and accruing interest include $50 million, $52 million and $55 million of loans accounted for as troubled debt restructurings at March 31, 2013, December 31, 2012 and November 30, 2012, respectively.

(3) Personal loans that are 90 or more days delinquent and accruing interest include $1 million, $2 million and $1 million of loans accounted for as troubled debt restructurings at March 31, 2013, December 31, 2012 and November 30, 2012.

(4) Private student loans that are 90 or more days delinquent and accruing interest include $2 million, $2 million and $2 million of loans accounted for as troubled debt restructurings at March 31, 2013, December 31, 2012 and November 30, 2012.

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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 income 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 March 31,				For the One Month Ended December 31,	
	2013		2012		2012	
	Net Charge-offs	Net Charge-off Rate	Net Charge-offs	Net Charge-off Rate	Net Charge-offs	Net Charge-off Rate
Credit card loans:						
Discover card	$286	2.36 %	$336	2.91 %	$106	2.48 %
Discover business card	1	2.66 %	2	3.94 %	—	2.08 %
Total credit card loans	287	2.36 %	338	2.92 %	106	2.47 %
Other loans:						
Personal loans	19	2.30 %	17	2.56 %	7	2.52 %
Private student loans (excluding PCI)	7	0.82 %	3	0.48 %	2	0.81 %
Total other loans (excluding PCI)	26	1.49 %	20	1.52 %	9	1.61 %
Net charge-offs as a percentage of total loans (excluding PCI)	$313	2.25 %	$358	2.77 %	$115	2.37 %
Net charge-offs as a percentage of total loans (including PCI)	$313	2.08 %	$358	2.52 %	$115	2.19 %

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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. FICO 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 the most recent FICO scores available for the Company's customers as a percentage of each class of loan receivables:

	Credit Risk Profile by FICO Score			
	660 and Above		Less than 660 or No Score	
At March 31, 2013				
Discover card	82	%	18	%
Discover business card	91	%	9	%
Personal loans	97	%	3	%
Private student loans (excluding PCI) [(1)]	95	%	5	%
At December 31, 2012				
Discover card	83	%	17	%
Discover business card	91	%	9	%
Personal loans	97	%	3	%
Private student loans (excluding PCI) [(1)]	95	%	5	%
At November 30, 2012				
Discover card	82	%	18	%
Discover business card	91	%	9	%
Personal loans	97	%	3	%
Private student loans (excluding PCI) [(1)]	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 March 31, 2013, December 31, 2012 and November 30, 2012, there were $148 million, $183 million and $142 million of loans in forbearance, respectively. In addition, at March 31, 2013, December 31, 2012 and November 30, 2012, there were 2.8%, 3.4% and 2.6% of private student loans in forbearance as a percentage of student loans in repayment and forbearance. At December 31, 2012, the dollar amount of loans in forbearance and loans in forbearance as a percentage of private student loans in repayment and forbearance were higher due to administrative forbearances that were offered to certain customers impacted by Hurricane Sandy.

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."

The following tables provide changes in the Company's allowance for loan losses for the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012, respectively (dollars in millions):

	For the Three Months Ended March 31, 2013				
	Credit Card	Personal Loans	Student Loans	Other	Total
Balance at beginning of period	$1,613	$99	$75	$1	$1,788
Additions:					
Provision for loan losses	127	17	15	—	159
Deductions:					
Charge-offs	(422)	(20)	(7)	—	(449)
Recoveries	135	1	—	—	136
Net charge-offs	(287)	(19)	(7)	—	(313)
Balance at end of period	$1,453	$97	$83	$1	$1,634

	For the Three Months Ended March 31, 2012				
	Credit Card	Personal Loans	Student Loans	Other	Total
Balance at beginning of period	$2,101	$85	$59	$—	$2,245
Additions:					
Provision for loan losses	59	23	2	—	84
Deductions:					
Charge-offs	(490)	(18)	(3)	—	(511)
Recoveries	152	1	—	—	153
Net charge-offs	(338)	(17)	(3)	—	(358)
Balance at end of period	$1,822	$91	$58	$—	$1,971

	For the One Month Ended December 31, 2012				
	Credit Card	Personal Loans	Student Loans	Other	Total
Balance at beginning of period	$1,554	$97	$73	$1	$1,725
Additions:					
Provision for loan losses	165	9	4	—	178
Deductions:					
Charge-offs	(146)	(8)	(2)	—	(156)
Recoveries	40	1	—	—	41
Net charge-offs	(106)	(7)	(2)	—	(115)
Balance at end of period	$1,613	$99	$75	$1	$1,788

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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 millions):

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
Interest and fees accrued subsequently charged off, net of recoveries (recorded as a reduction of interest income)	$77	$99	$26
Fees accrued subsequently charged off, net of recoveries (recorded as a reduction to other income)	$16	$19	$5

The following tables provide 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 millions):

	Credit Card	Personal Loans	Student Loans	Other Loans	Total
At March 31, 2013					
Allowance for loans evaluated for impairment as:					
Collectively evaluated for impairment in accordance with ASC 450-20	$1,266	$93	$78	$1	$1,438
Evaluated for impairment in accordance with ASC 310-10-35 (1)	187	4	5	—	196
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	—	—	—
Total allowance for loan losses	$1,453	$97	$83	$1	$1,634
Recorded investment in loans evaluated for impairment as:					
Collectively evaluated for impairment in accordance with ASC 450-20	$47,409	$3,372	$3,407	$36	$54,224
Evaluated for impairment in accordance with ASC 310-10-35 (1)	1,246	23	19	—	1,288
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	4,561	—	4,561
Total recorded investment	$48,655	$3,395	$7,987	$36	$60,073
At December 31, 2012					
Allowance for loans evaluated for impairment as:					
Collectively evaluated for impairment in accordance with ASC 450-20	$1,433	$95	$71	$1	$1,600
Evaluated for impairment in accordance with ASC 310-10-35 (1)	180	4	4	—	188
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	—	—	—
Total allowance for loan losses	$1,613	$99	$75	$1	$1,788
Recorded investment in loans evaluated for impairment as:					
Collectively evaluated for impairment in accordance with ASC 450-20	$49,826	$3,275	$3,056	$38	$56,195
	1,309	21	16	—	1,346

Evaluated for impairment in accordance with ASC 310-10-35 [1]					
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	4,702	—	4,702
Total recorded investment	$51,135	$3,296	$7,774	$38	$62,243

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	Credit Card	Personal Loans	Student Loans	Other Loans	Total
At November 30, 2012					
Allowance for loans evaluated for impairment as:					
Collectively evaluated for impairment in accordance with ASC 450-20	$1,373	$93	$69	$1	$1,536
Evaluated for impairment in accordance with ASC 310-10-35 [(1)]	181	4	4	—	189
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	—	—	—
Total allowance for loan losses	$1,554	$97	$73	$1	$1,725
Recorded investment in loans evaluated for impairment as:					
Collectively evaluated for impairment in accordance with ASC 450-20	$48,310	$3,251	$2,985	$37	$54,583
Evaluated for impairment in accordance with ASC 310-10-35 [(1)]	1,332	21	15	—	1,368
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	4,744	—	4,744
Total recorded investment	$49,642	$3,272	$7,744	$37	$60,695

(1) Represents loans collectively 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 $1.1 billion, $1.1 billion and $1.1 billion at March 31, 2013, December 31, 2012 and November 30, 2012, respectively. The unpaid principal balance of personal loans was $23 million, $21 million and $21 million at March 31, 2013, December 31, 2012 and November 30, 2012, respectively. The unpaid principal balance of student loans was $18 million, $15 million and $14 million at March 31, 2013, December 31, 2012 and November 30, 2012, respectively. All loans accounted for as troubled debt restructurings have a related allowance for loan losses.

Impaired Loans and Troubled Debt Restructurings. Permanent and certain temporary modification programs for credit card loans as well as loans that defaulted or graduated from modification programs, certain grants of student loan forbearance and certain modifications to personal loans as well as those that defaulted or graduated from modification programs 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.

To assist student loan borrowers who are experiencing temporary financial difficulties but 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, we offer two temporary programs which 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. In addition, the temporary APR reduction program also provides an interest rate reduction for up to 12 months. The permanent programs involve changing the terms of the loan in order to pay off the outstanding balance over the new term for a period no longer than 4 years. The total term, including both the original and renegotiated terms, generally does not exceed 9 years. We offer another permanent program which modifies the interest rate along with the term of the loan. The Company also allows loan modifications for personal loan customers who request financial assistance through external sources, similar to our credit

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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 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 classified as troubled debt restructurings is shown below (dollars in millions):

	Average recorded investment in loans	Interest income recognized during period loans were impaired[1]	Gross interest income that would have been recorded with original terms[2]
For the Three Months Ended March 31, 2013			
Credit card loans			
Modified credit card loans [3]	$279	$13	$1
Internal programs	$490	$3	$17
External programs	$507	$10	$3
Personal loans [4]	$22	$1	N/A
Student loans [4]	$18	$—	N/A
For the Three Months Ended March 31, 2012			
Credit card loans			
Modified credit card loans [3]	$274	$12	$1
Internal programs	$570	$4	$18
External programs	$631	$14	$2
Personal loans [4]	$12	$—	N/A
Student loans [4]	$7	$—	N/A
For the One Month Ended December 31, 2012			
Credit card loans			
Modified credit card loans [3]	$281	$4	$—
Internal programs	$509	$1	$6
External programs	$530	$4	$1
Personal loans [4]	$21	$—	N/A
Student loans [4]	$16	$—	N/A

(1) The Company does not separately track interest income on loans in 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) For personal loan customers in modification programs, gross interest income that would have been recorded with original terms is not significant for accounts in which there was an APR reduction. Student loan customers who have been granted a forbearance are not given interest rate reductions.

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In order to evaluate the primary financial effects which resulted from loans entering into a loan modification program during the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012, the Company quantified the amount by which interest and fees were reduced during the period. During the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012, the Company forgave approximately $11 million, $12 million and $3 million, respectively, of interest and fees as a result of accounts entering into a loan modification program.

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

	For the Three Months Ended March 31,				For the One Month Ended December 31,	
	2013		2012		2012	
	Number of Accounts	Balances	Number of Accounts	Balances	Number of Accounts	Balances
Accounts that entered a loan modification program during the period:						
Credit card:						
Internal programs	10,402	$66	15,150	$106	3,078	$19
External programs	9,531	$52	10,950	$63	2,614	$14
Personal loans	443	$6	424	$5	120	$2
Student loans	172	$4	113	$2	60	$2

The following table presents the carrying value of loans that experienced a payment default during the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012 that had been modified in a troubled debt restructuring during the 15 months preceding the end of each period (dollars in millions):

	For the Three Months Ended March 31,				For the One Month Ended December 31,	
	2013		2012		2012	
	Number of Accounts	Aggregated Outstanding Balances Upon Default	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	2,880	$18	4,381	$30	945	$6
External programs	2,251	$10	2,781	$13	722	$3
Personal loans [(2)]	24	$—	35	$—	22	$—
Student loans [(4)]	135	$3	101	$2	42	$1

(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.
(4) Student loan defaults have been defined as 60 or more days delinquent.

Of the account balances that defaulted as shown above for the three months ended March 31, 2013, approximately 45% 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 months ended March 31, 2012, approximately 42% 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 one month ended December 31, 2012, approximately 39% 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 "-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 March 31, 2013, December 31, 2012 and November 30,

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2012. Total PCI student loans had an outstanding balance of $5.0 billion, $5.2 billion and $5.2 billion, including accrued interest, and a related carrying amount of $4.6 billion, $4.7 billion and $4.7 billion as of March 31, 2013, December 31, 2012 and November 30, 2012, respectively.

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.

The following table provides changes in accretable yield for the acquired loans for the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012 (dollars in millions):

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
Balance at beginning of period	$2,072	$2,554	$2,096
Accretion into interest income	(70)	(77)	(24)
Other changes in expected cash flows	19	(86)	—
Balance at end of period	$2,021	$2,391	$2,072

During each reporting period, the Company updates the estimate of cash flows expected to be collected based on management's latest expectations of future credit losses, borrower prepayments, and certain other assumptions that affect cash flows. While there were no changes to overall credit loss assumptions during the periods presented, changes to other cash flow expectations resulted in the changes to accretable yield reflected in the table above. These amounts will be recognized prospectively as an adjustment to yield over the remaining life of the pools.

At March 31, 2013, 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 2.18% and 0.80%, respectively. At December 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 2.68% and 0.86%, respectively. At November 30, 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 2.86% and 0.86%, 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 was 1.43%, 1.31% and 1.53% for the three months ended March 31, 2013 and 2012 and the one month ended December 31, 2012, 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 other income 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 carrying 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[1] (dollars in millions):

	For the Three Months Ended March 31, 2013			For the One Month Ended December 31, 2012		
	Amount	%		Amount	%	
Conforming [2]	$665	55.51	%	$218	60.06	%
FHA [3]	533	44.49	%	145	39.94	%
Total	$1,198	100.00	%	$363	100.00	%

(1) There were no comparable balances to report for the three months ended March 31, 2012 as the acquisition of Home Loan Center assets did not close until June 6, 2012.
(2) Conforming loans are loans that conform to Government Sponsored Enterprises guidelines.
(3) FHA loans are loans that are insured by the Federal Housing Administration and are typically made to borrowers with low down payments. The loan amount must be within certain limits.

The following table represents the loans held for sale by type of loan (dollars in millions):

	March 31, 2013			December 31, 2012			November 30, 2012		
	Amount	%		Amount	%		Amount	%	
Conforming [1]	$179	57.56	%	$177	49.86	%	$178	55.28	%
FHA [2]	132	42.44	%	178	50.14	%	144	44.72	%
Total	$311	100.00	%	$355	100.00	%	$322	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 and are typically made to borrowers with low down payments. The loan amount must be within 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 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. 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 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 condensed 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 millions):

	March 31, 2013	December 31, 2012	November 30, 2012
Cash collateral accounts	$84	$93	$148
Collections and interest funding accounts	291	91	2,111
Restricted cash	375	184	2,259
Investors' interests held by third-party investors	14,676	13,768	15,818
Investors' interests held by wholly owned subsidiaries of Discover Bank	4,844	5,038	5,209
Seller's interest	13,110	15,976	12,737
Loan receivables [(1)]	32,630	34,782	33,764
Allowance for loan losses allocated to securitized loan receivables [(1)]	(988)	(1,110)	(1,069)
Net loan receivables	31,642	33,672	32,695
Other	31	29	30
Carrying value of assets of consolidated variable interest entities	$32,048	$33,885	$34,984

(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. Sellers' interest is impacted by seasonality as higher balance repayments tend to occur in the first calendar year quarter. 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 receivables 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 March 31, 2013, no economic or other early amortization events have occurred.

The tables below provide information concerning investors’ interests and related excess spreads at March 31, 2013 (dollars in millions):

	Investors’ Interests [(1)]	# of Series Outstanding
Discover Card Master Trust I	$1,310	3
Discover Card Execution Note Trust (DiscoverSeries notes)	18,210	37
Total investors’ interests	$19,520	40

(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	12.97 %
DiscoverSeries excess spread percentage	12.92 %

(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.

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.

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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 millions):

	March 31, 2013	December 31, 2012	November 30, 2012
Restricted cash	$99	$96	$78
Student loan receivables	2,461	2,539	2,563
Carrying value of assets of consolidated variable interest entities	$2,560	$2,635	$2,641

6. Deposits

The Company offers its deposit products to customers through two channels: (i) through direct marketing, internet origination and affinity relationships ("direct-to-consumer deposits"); and (ii) indirectly through contractual arrangements with securities brokerage firms ("brokered deposits"). Direct-to-consumer deposits include certificates of deposit, money market accounts, online savings and checking accounts, and IRA certificates of deposit, while brokered deposits include certificates of deposit and sweep accounts.

As of March 31, 2013, December 31, 2012 and November 30, 2012, the Company had approximately $28.7 billion, $28.0 billion and $27.9 billion, respectively, of direct-to-consumer deposits and approximately $13.6 billion, $14.1 billion and $14.1 billion, respectively, of brokered deposits.

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

	March 31, 2013	December 31, 2012	November 30, 2012
Certificates of deposit in amounts less than $100,000 [(1)]	$21,111	$21,070	$21,039
Certificates of deposit from amounts of $100,000 [(1)] to less than $250,000 [(1)]	5,613	5,508	5,460
Certificates of deposit in amounts of $250,000 [(1)] or greater	1,328	1,280	1,276
Savings deposits, including money market deposit accounts	14,203	14,219	14,259
Total interest-bearing deposits	$42,255	$42,077	$42,034
Average annual interest rate	1.73 %	1.74 %	1.94 %

(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 March 31, 2013, certificates of deposit maturing over the remainder of 2013, over each of the next four years, and thereafter were as follows (dollars in millions):

Year	Amount
2013	$10,662
2014	$7,495
2015	$4,280
2016	$2,206
2017	$1,879
Thereafter	$1,530

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7. Long-Term 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 millions):

	March 31, 2013		December 31, 2012			
	Outstanding	Interest Rate	Outstanding	Interest Rate	Interest Rate Terms	Maturity
Securitized Debt						
Fixed rate asset-backed securities						
Principal value (including discount of $1)	$5,449	2.51 %	$4,549	2.87 %	Various fixed rates	Various June 2013— July 2019
Fair value adjustment [1]	6		6			
Book value	5,455		4,555			
Floating rate asset-backed securities	8,476	0.47 %	8,468	0.50 %	1-month LIBOR(2) + 8 to 58 basis points	Various May 2013— February 2018
Floating rate asset-backed securities and other borrowings	750	0.62 %	750	0.64 %	Commercial Paper rate +30 to 70 basis points	April 2013— March 2014
Total Discover Card Master Trust I and Discover Card Execution Note Trust	14,681		13,773			
Floating rate asset-backed securities (including discount of $161)	1,150	0.52 %	1,199	0.56 %	3-month LIBOR(2) + 12 to 45 basis points	Various January 2019— July 2036(3)
Floating rate asset-backed securities (including discount of $3)	503	4.25 %	528	4.25 %	Prime rate +100 basis points	June 2031(3)
Floating rate asset-backed securities (including premium of $2)	120	4.00 %	126	4.00 %	Prime rate + 75 basis points	July 2042(3)
Floating rate asset-backed securities (including premium of $4)	290	3.70 %	307	3.71 %	1-month LIBOR(2) + 350 basis points	July 2042(3)
Total SLC Private Student Loan Trusts	2,063		2,160			
Total Long-Term Borrowings—owed to securitization investors	16,744		15,933			
Discover Financial Services (Parent Company)						
Fixed rate senior notes due 2017						
Principal value	400	6.45 %	400	6.45 %	Fixed	June 2017
Fair value adjustment [1]	20		21			
Book value	420		421			
Fixed rate senior notes due 2019	78	10.25 %	78	10.25 %	Fixed	July 2019

Fixed rate senior notes due 2022 (including discount of $109)	213	5.20	%	211	5.20	%	Fixed	April 2022
Fixed rate senior notes due 2022 (including discount of $174)	326	3.85	%	324	3.85	%	Fixed	November 2022
Discover Bank								
Senior bank notes due 2018	750	2.00	%	—	—	%	Fixed	February 2018
Subordinated bank notes due 2019	200	8.70	%	200	8.70	%	Fixed	November 2019
Subordinated bank notes due 2020 (including discount of $2)	498	7.00	%	497	7.00	%	Fixed	April 2020
Capital lease obligations	1	4.51	%	2	4.51	%	Fixed	April 2016
Total long-term borrowings	$19,230			$17,666				

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	November 30, 2012		
	Outstanding	Interest Rate	
Securitized Debt			
Fixed rate asset-backed securities			
Principal value	$4,549	2.87	%
Fair value adjustment [(1)]	7		
Book value	4,556		
Floating rate asset-backed securities	9,268	0.49	%
Floating rate asset-backed securities	1,250	0.73	%
Floating rate asset-backed securities and other borrowings	750	0.63	%
Total Discover Card Master Trust I and Discover Card Execution Note Trust	15,824		
Floating rate asset-backed securities	1,195	0.56	%
Floating rate asset-backed securities	536	4.25	%
Floating rate asset-backed securities	128	4.00	%
Floating rate asset-backed securities	312	3.71	%
Total SLC Private Student Loan Trusts	2,171		
Total Long-Term Borrowings—owed to securitization investors	17,995		
Discover Financial Services (Parent Company)			
Fixed rate senior notes due 2017			
Principal value	400	6.45	%
Fair value adjustment [(1)]	23		
Book value	423		
Fixed rate senior notes due 2019	78	10.25	%
Fixed rate senior notes due 2022	211	5.20	%
Fixed rate senior notes due 2022	323	3.85	%
Discover Bank			
Subordinated bank notes due 2019	200	8.70	%
Subordinated bank notes due 2020	497	7.00	%
Capital lease obligations	2	4.51	%
Total long-term borrowings	$19,729		

(1) The Company uses interest rate swaps to hedge portions of these long-term borrowings against changes in fair value attributable to changes in LIBOR. See Note 15: Derivatives and Hedging Activities.

(2) London Interbank Offered Rate ("LIBOR").

(3) Repayment of this debt is dependent upon the timing of principal and interest payments on the underlying student loans. The dates shown represent final maturity dates.

Maturities. Long-term borrowings had the following maturities at March 31, 2013 (dollars in millions):

Year	Amount
Due in 2013	$2,337
Due in 2014	4,290
Due in 2015	3,306
Due in 2016	1,300
Due in 2017	2,069
Thereafter	5,928

Total	$19,230

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In the fourth quarter 2012, the Company completed a private exchange offer, resulting in the exchange of $500 million outstanding aggregate principal amount of 8.70% Subordinated Notes due 2019 issued by Discover Bank for the same aggregate principal amount of new 3.85% Senior Notes due 2022 issued by Discover Financial Services and a cash premium paid of $176 million. The exchange was accounted for as a debt modification and not as an extinguishment. The entire outstanding aggregate principal amount of these notes was subsequently exchanged for substantially identical notes that were registered under the Securities Act of 1933. During the three months ended March 31, 2013 and the one month ended December 31, 2012, respectively, $3 million and $1 million of the premium paid was amortized and included in interest expense on the condensed consolidated statement of income.

During second quarter 2012, the Company completed a private exchange offer, resulting in the exchange of $322 million outstanding aggregate principal amount of 10.25% Senior Notes due 2019 for the same aggregate principal amount of new 5.20% Senior Notes due 2022 and a cash premium paid of $115 million. On April 27, 2012, the Company issued $308 million aggregate principal amount and, on May 8, 2012, the Company issued $14 million aggregate principal amount, respectively, of the 5.20% Senior Notes due 2022. The exchange was accounted for as a debt modification and not as an extinguishment. Approximately $318 million of these notes were subsequently exchanged for substantially identical notes that were registered under the Securities Act of 1933. During the three months ended March 31, 2013 and the one month ended December 31, 2012, respectively, $2 million and $1 million of the premium paid was amortized and included in interest expense on the condensed consolidated statement of income.

The Company has access to committed undrawn capacity through private securitizations to support the funding of its credit card loan receivables. As of March 31, 2013, the total commitment of secured credit facilities through private providers was $7.5 billion, of which $750 million had been used and was included in long-term borrowings at March 31, 2013. Access to the unused portions of the secured credit facilities is dependent upon the agreement with each of the providers which have various expirations in 2014, 2015 and 2016. Borrowings outstanding under each facility bear interest at a margin above LIBOR or the asset-backed commercial paper costs of each individual conduit provider. The terms of each agreement provide for a commitment fee to be paid on the unused capacity, and include various affirmative and negative covenants, including performance metrics and legal requirements similar to those required to issue any term securitization transaction.

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8. Accumulated Other Comprehensive Income

Changes in each component of accumulated other comprehensive income (loss) were as follows (dollars in millions):

	Gain (Loss) on Available-for-Sale Investment Securities, Net of Tax	Gain (Loss) on Cash Flow Hedges, Net of Tax	Pension and Post Retirement Plan Gain (Loss), Net of Tax	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 2011	$ 60	$7	$(116)	$(49)
Net unrealized losses on investment securities, net of tax benefit of $4 [(1)]	(8)	—	—	(8)
Unrealized losses on cash flow hedges, net of tax benefit of $1 [(2)]	—	(2)	—	(2)
Unrealized pension and postretirement plan gain, net of tax expense [(3)]	—	—	1	1
Balance at March 31, 2012	$ 52	$5	$(115)	$(58)
Balance at November 30, 2012	$ 74	$3	$(152)	$(75)
Net unrealized losses on investment securities, net of tax benefit of $2 [(1)]	(3)	—	—	(3)
Unrealized pension and postretirement plan gain, net of tax expense of $4 [(3)]	—	—	6	6
Balance at December 31, 2012	71	3	(146)	(72)
Other comprehensive income before reclassifications [(1)(2)(3)(4)]	(10)	—	—	(10)
Amounts reclassified from accumulated other comprehensive income [(5)]	(1)	(1)	—	(2)
Balance at March 31, 2013	$ 60	$2	$(146)	$(84)

(1) Represents the difference between the fair value and amortized cost of available-for-sale investment securities.

(2) Represents unrealized gains (losses) related to effective portion of cash flow hedges.

(3) Reflects adjustments to the funded status of pension and postretirement plans, which is the difference between the fair value of the plan assets and the projected benefit obligation.

(4) Unrealized losses on available-for-sale investments are net of tax benefit of $5 million for the three months ended March 31, 2013.

(5) Amounts reclassified out of accumulated other comprehensive income include unrealized gains of $1 million (net of tax expense of $1 million) on the sale of available-for-sale investments and unrealized gains of $1 million (net of tax expense of $1 million) on cash flow hedges recorded in other income and interest income, respectively, in the condensed consolidated statement of income.

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9. Income Taxes

Income tax expense consisted of the following (dollars in millions):

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
Current:			
U.S. federal	$247	$249	$101
U.S. state and local	38	39	15
International	1	1	—
Total	286	289	116
Deferred:			
U.S. federal	111	100	(11)
U.S. state and local	10	8	(1)
Total	121	108	(12)
Income tax expense	$407	$397	$104

The following table reconciles the Company’s effective tax rate to the U.S. federal statutory income tax rate:

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
U.S. federal statutory income tax rate	35.0 %	35.0 %	35.0 %
U.S. state, local and other income taxes, net of U.S. federal income tax benefits	3.3	3.3	3.2
Other	(0.6)	(0.4)	(0.1)
Effective income tax rate	37.7 %	37.9 %	38.1 %

The Company is subject to examination by the Internal Revenue Service ("IRS") and the tax authorities in various states. The tax years under examination vary by jurisdiction. The Company is pursuing an administrative appeal of the IRS’s proposed assessment for the years 1999 through 2005, when Discover was a subsidiary of Morgan Stanley. With respect to the issues still pending on appeal for the years 1999 through 2005, the ultimate outcome remains uncertain. It is reasonably possible that a settlement of the IRS appeal and certain state audits may be made within 12 months of the reporting date. At this time, the Company believes it is reasonably possible that a reduction in the amount of unrecognized tax benefits of $109 million could be recognized as a result of such settlements.

The IRS is currently examining 2006 through June 20, 2007. This period is also part of a Morgan Stanley audit. A separate post-spin examination covers the years 2008 through 2010. The Company regularly assesses the likelihood of additional assessments or settlements in each of the taxing jurisdictions resulting from these and subsequent years' examinations. The Company believes that its reserves are sufficient to cover any tax, penalties and interest that could result from such examinations.

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10. Earnings Per Share

The following table presents the calculation of basic and diluted earnings per share ("EPS") (in millions, except per share amounts):

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
Numerator:			
Net income	$673	$650	$170
Preferred stock dividends	(9)	—	—
Net income available to common stockholders	664	650	170
Income allocated to participating securities	(5)	(6)	(2)
Net income allocated to common stockholders	$659	$644	$168
Denominator:			
Weighted average shares of common stock outstanding	496	530	498
Effect of dilutive common stock equivalents	1	1	1
Weighted average shares of common stock outstanding and common stock equivalents	497	531	499
Basic earnings per share	$1.33	$1.22	$0.34
Diluted earnings per share	$1.33	$1.21	$0.34

Anti-dilutive securities were not material and had no impact on the computation of diluted EPS for the three months ended March 31, 2013 and 2012 or the one month ended December 31, 2012.

11. Capital Adequacy

The Company is subject to capital adequacy guidelines of the Federal Reserve, and Discover Bank (the “Bank”), the Company’s main banking subsidiary, is subject to various regulatory capital requirements as administered by the Federal Deposit Insurance Corporation (the “FDIC”). Failure to meet minimum capital requirements can result in the initiation of certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the financial position and results of the Company and the Bank. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items, as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (as defined in the regulations) of total risk-based capital and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets. As of March 31, 2013, the Company and the Bank met all capital adequacy requirements to which they were subject. Under regulatory capital requirements, the Company and the Bank must maintain minimum levels of capital that are dependent upon the risk-weighted amount or average level of the financial institution’s assets, specifically (a) 8% to 10% of total risk-based capital to risk-weighted assets (“total risk-based capital ratio”), (b) 4% to 6% of Tier 1 capital to risk-weighted assets (“Tier 1 risk-based capital ratio”) and (c) 4% to 5% of Tier 1 capital to average assets (“Tier 1 leverage ratio”). To be categorized as “well-capitalized,” the Company and the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. As of March 31, 2013, the Company and the Bank met the requirements for well-capitalized status and there have been no conditions or events that management believes have changed the Company’s or the Bank’s category.

The following table shows the actual capital amounts and ratios of the Company and the Bank as of March 31, 2013, December 31, 2012 and November 30, 2012 and comparisons of each to the regulatory minimum and “well-capitalized”

requirements (dollars in millions):

	Actual			Minimum Capital Requirements		Capital Requirements To Be Classified as Well-Capitalized	
	Amount	Ratio		Amount	Ratio	Amount	Ratio
March 31, 2013							
Total capital (to risk-weighted assets)							
Discover Financial Services	$11,411	17.9	%	$5,088	≥8.0%	$6,360	≥10.0%
Discover Bank	$9,926	15.8	%	$5,013	≥8.0%	$6,266	≥10.0%
Tier 1 capital (to risk-weighted assets)							
Discover Financial Services	$9,909	15.6	%	$2,544	≥4.0%	$3,816	≥6.0%
Discover Bank	$8,435	13.5	%	$2,507	≥4.0%	$3,760	≥6.0%
Tier 1 capital (to average assets)							
Discover Financial Services	$9,909	13.4	%	$2,963	≥4.0%	$3,704	≥5.0%
Discover Bank	$8,435	11.6	%	$2,922	≥4.0%	$3,652	≥5.0%
December 31, 2012							
Total capital (to risk-weighted assets)							
Discover Financial Services	$10,998	16.8	%	$5,242	≥8.0%	$6,552	≥10.0%
Discover Bank	$9,615	14.9	%	$5,172	≥8.0%	$6,465	≥10.0%
Tier 1 capital (to risk-weighted assets)							
Discover Financial Services	$9,470	14.5	%	$2,621	≥4.0%	$3,931	≥6.0%
Discover Bank	$8,097	12.5	%	$2,586	≥4.0%	$3,879	≥6.0%
Tier 1 capital (to average assets)							
Discover Financial Services	$9,470	12.7	%	$2,987	≥4.0%	$3,734	≥5.0%
Discover Bank	$8,097	11.0	%	$2,936	≥4.0%	$3,670	≥5.0%
November 30, 2012							
Total capital (to risk-weighted assets)							
Discover Financial Services	$10,899	16.8	%	$5,204	≥8.0%	$6,505	≥10.0%
Discover Bank	$9,455	14.7	%	$5,136	≥8.0%	$6,420	≥10.0%
Tier 1 capital (to risk-weighted assets)							
Discover Financial Services	$9,377	14.4	%	$2,602	≥4.0%	$3,903	≥6.0%
Discover Bank	$7,944	12.4	%	$2,568	≥4.0%	$3,852	≥6.0%
Tier 1 capital (to average assets)							
Discover Financial Services	$9,377	12.6	%	$2,984	≥4.0%	$3,730	≥5.0%
Discover Bank	$7,944	10.9	%	$2,928	≥4.0%	$3,660	≥5.0%

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12. Commitments, Contingencies and Guarantees

Lease commitments. The Company leases various office space and equipment under capital and non-cancelable operating leases which expire at various dates through 2022. At March 31, 2013, future minimum payments on leases with original terms in excess of one year consist of the following (dollars in millions):

	Capitalized Leases	Operating Leases
2013	$—	$11
2014	1	14
2015	—	9
2016	—	9
2017	—	8
Thereafter	—	11
Total minimum lease payments	$1	$62
Less: Amount representing interest	—	
Present value of net minimum lease payments	$1	

Unused commitments to extend credit. At March 31, 2013, the Company had unused commitments to extend credit for loans of approximately $163.7 billion. Such commitments arise primarily from agreements with customers for unused lines of credit on certain credit cards and certain other loan products, provided there is no violation of conditions in the related agreement. These commitments, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage, customer creditworthiness and loan qualification.

Commitments to purchase private student loans. On December 31, 2010, Discover Bank entered into an agreement with Citibank to purchase any private student loans originated subsequent to the contract date including a premium equal to 0.125%. The agreement expired on December 31, 2012. Although no loans were purchased by Discover Bank subsequent December 31, 2012, Discover Bank is obligated to disburse funds for previously purchased loans. As of March 31, 2013, Discover Bank had an outstanding commitment to disburse $4 million for loans purchased prior to December 31, 2012. For the loans purchased under the agreement, the Company has limited involvement with respect to the underwriting and setting credit terms. The underwriting standards for these loans are based on Citibank's credit policy, and those standards are not substantially different than the Company's own underwriting criteria. Based on this and by virtue of the fact that the loans are newly originated at the time that the Company acquires them, the loans are not considered purchased credit-impaired.

Securitizations Representations and Warranties. As part of the Company's financing activities, the Company provides representations and warranties that certain assets pledged as collateral in secured borrowing arrangements conform to specified guidelines. Due diligence is performed by the Company which is intended to ensure that asset guideline qualifications are met. If the assets pledged as collateral do not meet certain conforming guidelines, the Company may be required to replace, repurchase or sell such assets. In its credit card securitization activities, the Company would replace nonconforming receivables through the allocation of excess seller's interest or from additional transfers from the unrestricted pool of receivables. If the Company could not add enough receivables to satisfy the requirement, an early amortization (or repayment) of investors' interests would be triggered. In its student loan securitizations, the Company would generally repurchase the loans from the trust at the outstanding principal amount plus interest.

The maximum potential amount of future payments the Company could be required to make would be equal to the current outstanding balances of third-party investor interests in credit card asset-backed securities plus the principal amount of any other outstanding secured borrowings. The Company has recorded substantially all of the maximum potential amount of future payments in long-term borrowings on the Company's statement of financial condition. The Company has not recorded any incremental contingent liability associated with its secured borrowing representations and warranties. Management believes that the probability of having to replace, repurchase or sell assets pledged as collateral under secured borrowing arrangements, including an early amortization event, is low.

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Mortgage Loans Representations and Warranties. The Company sells loans it originates to investors on a servicing released basis and the risk of loss or default by the borrower is generally transferred to the investor. However, the Company is required by these investors to make certain representations and warranties relating to credit information, loan documentation and collateral. These representations and warranties may extend through the contractual life of the mortgage loan. Subsequent to the sale, if underwriting deficiencies, borrower fraud or documentation defects are discovered in individual mortgage loans, the Company may be obligated to repurchase the respective mortgage loan or indemnify the investors for any losses from borrower defaults if such deficiency or defect cannot be cured within the specified period following discovery. The Company has established a repurchase reserve based on expected losses. At March 31, 2013, this amount was not material and was included in other income on the condensed consolidated statements of income and in accrued expenses and other liabilities on the condensed consolidated statements of financial condition.

Guarantees. The Company has obligations under certain guarantee arrangements, including contracts and indemnification agreements, which contingently require the Company to make payments to the guaranteed party based on changes in an underlying asset, liability or equity security of a guaranteed party, rate or index. Also included as guarantees are contracts that contingently require the Company to make payments to a guaranteed party based on another entity’s failure to perform under an agreement. The Company’s use of guarantees is disclosed below by type of guarantee.

Counterparty Settlement Guarantees. Diners Club and DFS Services LLC, on behalf of PULSE, have various counterparty exposures, which are listed below.

- Merchant Guarantee. Diners Club has entered into contractual relationships with certain international merchants, which generally include travel-related businesses, for the benefit of all Diners Club licensees. The licensees hold the primary liability to settle the transactions of their customers with these merchants. However, Diners Club retains a counterparty exposure if a licensee fails to meet its financial payment obligation to one of these merchants.
- ATM Guarantee. PULSE entered into contractual relationships with certain international ATM acquirers in which DFS Services LLC retains counterparty exposure if an issuer fails to fulfill its settlement obligation.

The maximum potential amount of future payments related to such contingent obligations is dependent upon the transaction volume processed between the time a counterparty defaults on its settlement and the time at which the Company disables the settlement of any further transactions for the defaulting party, which could be up to one month depending on the type of guarantee/counterparty. However, there is no limitation on the maximum amount the Company may be liable to pay. The actual amount of the potential exposure cannot be quantified as the Company cannot determine whether particular counterparties will fail to meet their settlement obligations. While the Company has some contractual remedies to offset these counterparty settlement exposures (such as letters of credit or pledged deposits), in the event that all licensees and/or issuers were to become unable to settle their transactions, the Company estimates its maximum potential counterparty exposures to these settlement guarantees, based on historical transaction volume of up to one month, would be as follows:

	March 31, 2013
Diners Club:	
Merchant guarantee (in millions)	$242
PULSE:	
ATM guarantee (in millions)	$1

With regard to the counterparty settlement guarantees discussed above, the Company believes that the estimated amounts of maximum potential future payments are not representative of the Company’s actual potential loss exposure given Diners Club’s and PULSE’s insignificant historical losses from these counterparty exposures. As of March 31, 2013, the Company had not recorded any contingent liability in the condensed consolidated financial statements for these counterparty exposures, and management believes that the probability of any payments under these arrangements is low.

The Company also retains counterparty exposure for the obligations of Diners Club licensees that participate in the Citishare network, an electronic funds processing network. Through the Citishare network, Diners Club customers are able to access certain ATMs directly connected to the Citishare network. The Company's maximum potential future payment under this counterparty exposure is limited to $15 million subject to annual adjustment based on actual transaction experience. However, as of March 31, 2013, the Company had not recorded any contingent liability in the condensed consolidated financial statements related to this counterparty exposure, and management believes that the probability of any payments under this arrangement is low.

Merchant Chargeback Guarantees. The Company issues and permits third parties to issue payment cards and owns and operates the Discover Network. The Company is contingently liable for certain transactions processed on the Discover Network in the event of a dispute between the payment card customer and a merchant. The contingent liability arises if the disputed

transaction involves a merchant or merchant acquirer with whom the Discover Network has a direct relationship. If a dispute is resolved in the customer's favor, the Discover Network will credit or refund the disputed amount to the Discover Network card issuer, who in turn credits its customer's account. The Discover Network will then charge back the disputed amount of the payment card transaction to the merchant or merchant acquirer, where permitted by the applicable agreement, to seek recovery of amounts already paid to the merchant for payment card transactions. If the Discover Network is unable to collect the amount subject to dispute from the merchant or merchant acquirer (e.g., in the event of merchant default or dissolution) or after expiration of the time period for chargebacks in the applicable agreement, the Discover Network will bear the loss for the amount credited or refunded to the customer. In most instances, a loss by the Discover Network is unlikely to arise in connection with payments on card transactions because most products or services are delivered when purchased, and credits are issued by merchants on returned items in a timely fashion, thus minimizing the likelihood of cardholder disputes with respect to amounts paid by the Discover Network. However, where the product or service is not scheduled to be provided to the customer until a later date following the purchase, the likelihood of a contingent payment obligation by the Discover Network increases. Losses related to merchant chargebacks were not material for the three months ended March 31, 2013, 2012 or for the one month ended December 31, 2012.

The maximum potential amount of obligations of the Discover Network arising as a result of such contingent obligations is estimated to be the portion of the total Discover Network transaction volume processed to date for which timely and valid disputes may be raised under applicable law and relevant issuer and customer agreements. There is no limitation on the maximum amount the Company may be liable to pay to issuers. However, the Company believes that such amount is not representative of the Company's actual potential loss exposure based on the Company's historical experience. The actual amount of the potential exposure cannot be quantified as the Company cannot determine whether the current or cumulative transaction volumes may include or result in disputed transactions.

The table below summarizes certain information regarding merchant chargeback guarantees (in millions):

	For the Three Months Ended March 31,		For the One Month Ended December 31,
	2013	2012	2012
Aggregate sales transaction volume [1]	$27,228	$26,013	$11,521

(1) Represents period transactions processed on the Discover Network for which a potential liability exists that, in aggregate, can differ from credit card sales volume.

The Company has not recorded any contingent liability in the condensed consolidated financial statements for merchant chargeback guarantees as of March 31, 2013, December 31, 2012 and November 30, 2012. The Company mitigates the risk of potential loss exposure by withholding settlement from merchants, obtaining third-party guarantees, or obtaining escrow deposits or letters of credit from certain merchant acquirers or merchants that are considered higher risk due to various factors such as time delays in the delivery of products or services. The table below provides information regarding settlement withholdings and escrow deposits, which are recorded in interest-bearing deposit accounts, and accrued expenses and other liabilities on the Company's condensed consolidated statements of financial condition (dollars in millions):

	March 31, 2013	December 31, 2012	November 30, 2012
Settlement withholdings and escrow deposits	$25	$25	$23

13. Litigation and Regulatory Matters

In the normal course of business, from time to time, the Company has been named as a defendant in various legal actions, including arbitrations, class actions, and other litigation, arising in connection with its activities. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. The Company contests liability and/or the amount of damages as appropriate in each pending matter.

The Company has historically relied on the arbitration clause in its cardmember agreements, which has in some instances limited the costs of, and the Company's exposure to, litigation, but there can be no assurance that the Company will continue to be successful in enforcing its arbitration clause in the future. Legal challenges to the enforceability of these clauses have led most card issuers, and may cause the Company, to discontinue their use. In addition, bills are periodically introduced in Congress to directly or indirectly prohibit the use of pre-dispute arbitration clauses, and the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Reform Act") authorized the Consumer Financial Protection Bureau (the "CFPB") to conduct a study on pre-dispute arbitration clauses and, based on the study, potentially limit or ban arbitration clauses. Further, the Company is involved in pending legal actions challenging its arbitration clause.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental agencies regarding the Company's business including, among other matters, accounting, tax and operational matters, some of which may result in significant adverse judgments, settlements, fines, penalties, injunctions, decreases in regulatory ratings or other relief, which could materially impact the Company's financial statements, increase its cost of operations, or limit its ability to execute its business strategies and engage in certain business activities. Such matters related to the IRS are discussed in Note 9: Income Taxes.

In accordance with applicable accounting guidance, the Company establishes an accrued liability for legal and regulatory matters when those matters present loss contingencies which are both probable and estimable. Litigation-related expense of $25 million was recognized for the three months ended March 31, 2012. Litigation expense was not material for the three months ended March 31, 2013 or the one month ended December 31, 2012. There may be an exposure to loss in excess of any amounts accrued. The Company believes the estimate of the aggregate range of reasonably possible losses (meaning those losses the likelihood of which is more than remote but less than likely) in excess of the amounts that the Company has accrued for legal and regulatory proceedings is up to $100 million. This estimated range of reasonably possible losses is based upon currently available information for those proceedings in which the Company is involved, takes into account the Company's best estimate of such losses for those matters for which an estimate can be made, and does not represent the Company's maximum potential loss exposure. Various aspects of the legal proceedings underlying the estimated range will change from time to time and actual results may vary significantly from the estimate.

The Company's estimated range above involves significant judgment, given the varying stages of the proceedings, the existence of numerous yet to be resolved issues, the breadth of the claims (often spanning multiple years and, in some cases, a wide range of business activities), unspecified damages and/or the novelty of the legal issues presented. The outcome of pending matters could be material to the Company's condensed consolidated financial condition, operating results and cash flows for a particular future period, depending on, among other things, the level of the Company's income for such period, and could adversely affect the Company's reputation.

On August 16, 2011, the Attorney General of West Virginia filed a lawsuit against the Company in the Circuit Court of Mason County, West Virginia (West Virginia v. Discover Financial Services, Inc., Discover Bank, DFS Services LLC et al.). The lawsuit asserts various claims related to the Company's marketing and administration of various protection products under West Virginia law. The relief sought in the lawsuit includes an injunction prohibiting the Company from engaging in the alleged violations, restitution and disgorgement of monies received from the complained of practices, civil penalties and costs. The Company will seek to vigorously defend all claims asserted against it in this matter.

On August 26, 2011, the Attorney General of Missouri issued a request for information to the Company in connection with an investigation to determine whether the Company has engaged in conduct that violates Missouri law in the marketing of its payment protection product to its credit card customers. The Company is cooperating with the Attorney General in the investigation.

On November 30, 2011, a class action lawsuit was filed against the Company by a cardmember in the U.S. District Court for the Northern District of California (Walter Bradley, et al. v. Discover Financial Services). The plaintiff

alleges that the Company contacted him, and members of the class he seeks to represent, on their cellular telephones without their express consent in violation of the Telephone Consumer Protection Act (“TCPA”). Plaintiff seeks statutory damages for alleged negligent and willful violations of the TCPA, attorneys' fees, costs and injunctive relief. The TCPA provides for statutory damages of $500 for each violation ($1,500 for willful violations).
On March 6, 2012, a class action lawsuit was filed against the Company by a cardmember in the U.S. District Court for the Northern District of California (Andrew Steinfeld, et al. v. Discover Financial Services, et al.). The plaintiff alleges that the Company contacted him, and members of the class he seeks to represent, on their cellular telephones without their express consent in violation of the TCPA. Plaintiff seeks statutory damages for alleged negligent and willful violations of the TCPA, attorneys' fees, costs and injunctive relief. The TCPA provides for statutory damages of $500 for each violation ($1,500 for willful violations).
On April 12, 2012, the Attorney General of Hawaii filed a lawsuit against the Company in the Circuit Court of the First Circuit, Hawaii (Hawaii v. Discover Financial Services, Inc., Discover Bank, DFS Services LLC et al.). The lawsuit asserts various claims related to the Company's marketing and administration of various protection products under Hawaii law. The relief sought in the lawsuit includes an injunction prohibiting named parties from engaging in the alleged violations, restitution and disgorgement of monies received from the complained of practices, civil penalties and costs. The Company will seek to vigorously defend against all claims asserted against it.
On June 28, 2012, the Attorney General of Mississippi filed a lawsuit against the Company in the Chancery Court of the First Judicial District of Hinds County, Mississippi (Mississippi v. Discover Financial Services, Inc., Discover Bank, DFS Services LLC et al.). The lawsuit asserts various claims related to the Company's marketing and administration of various protection products under Mississippi law. The relief sought in the lawsuit includes an injunction prohibiting the Company from engaging in the alleged violations, restitution and disgorgement of monies received from the complained-of practices, civil penalties and costs. The Company will seek to vigorously defend all claims asserted against it.
On July 5, 2012, the Antitrust Division of the United States Department of Justice (the “Division”) issued a Civil Investigative Demand (“CID”) to the Company seeking information regarding an investigation related to potential violations of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§1-2, by an unidentified party other than Discover. The CID seeks documents, data and narrative responses to several interrogatories and document requests, related to the debit card market. A CID is a request for information in the course of a civil investigation and does not constitute the commencement of legal proceedings. The Division is permitted by statute to issue a CID to anyone whom it believes may have information relevant to an investigation. The receipt of a CID does not presuppose that there is probable cause to believe that a violation of the antitrust laws has occurred or that a formal complaint ultimately will be filed. The Company is cooperating with the Division in connection with the CID.
On August 14, 2012, a purported shareholder, James Groen, filed a shareholder derivative action in the U.S. District Court for the Northern District of Illinois (Groen v. Nelms et al.) against the Company’s board of directors, certain current and former officers and directors, and the Company as nominal defendant. On August 27, 2012, a second purported shareholder, the Charter Township of Clinton Police and Fire Retirement System, filed a substantially identical shareholder derivative action in the same court against the same parties (Charter Township of Clinton Police and Fire Retirement System v. Nelms et al.). On September 25, 2012, the actions were consolidated, and on November 8, 2012, the plaintiffs filed a consolidated complaint. The consolidated complaint asserts claims against the board of directors and certain current and former officers and directors for alleged breach of fiduciary duty, corporate waste, and unjust enrichment arising out of the Company’s alleged violations of the law in connection with the marketing and sale of its protection products. The relief sought in the consolidated complaint includes changes to the Company’s corporate governance procedures; unspecified damages, injunctive relief, restitution, and disgorgement from the individual defendants; and attorneys’ fees. On December 21, 2012, the defendants filed a motion to dismiss the complaint. Rather than respond to the defendants' motion to dismiss, on February 19, 2013, the plaintiffs filed an amended consolidated complaint raising the same claims against the same defendants. On April 5, 2013, the defendants filed a motion to dismiss the amended consolidated complaint.
On April 17, 2013, the Attorney General of New Mexico filed a lawsuit against the Company in the First Judicial District Court, County of Santa Fe, New Mexico (New Mexico v. Discover Financial Services, Inc., Discover Bank, DFS Services LLC et al.). The lawsuit asserts various claims related to the Company's marketing and administration of various protection products under New Mexico law. The relief sought in the lawsuit includes an injunction

prohibiting the Company from engaging in the alleged violations, civil penalties and costs. The Company will seek to vigorously defend all claims asserted against it in this matter.

14. Fair Value Disclosures

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC Topic 820, Fair Value Measurement, provides a three-level hierarchy for classifying financial instruments, which is based on whether the inputs to the valuation techniques used to measure the fair value of each financial instrument are observable or unobservable. It also requires certain disclosures about those measurements. The three level valuation hierarchy is as follows:

- Level 1: Fair values determined by Level 1 inputs are defined as those that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access.
- Level 2: Fair values determined by Level 2 inputs are those that utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active or inactive markets, quoted prices for the identical assets in an inactive market, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. The Company evaluates factors such as the frequency of transactions, the size of the bid-ask spread and the significance of adjustments made when considering transactions involving similar assets or liabilities to assess the relevance of those observed prices. If relevant and observable prices are available, the fair values of the related assets or liabilities would be classified as Level 2.
- Level 3: Fair values determined by Level 3 inputs are those based on unobservable inputs, and include situations where there is little, if any, market activity for the asset or liability being valued. In instances in which the inputs used to measure fair value may fall into different levels of the fair value hierarchy, the level in the fair value hierarchy within which the fair value measurement in its entirety is classified is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company may utilize both observable and unobservable inputs in determining the fair values of financial instruments classified within the Level 3 category.

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The determination of classification of its financial instruments within the fair value hierarchy is performed at least quarterly by the Company. For transfers in and out of the levels of the fair value hierarchy, the Company discloses the fair value measurement based on the value immediately preceding the transfer.
The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and involves consideration of factors specific to the asset or liability. Furthermore, certain techniques used to measure fair value involve some degree of judgment and, as a result, are not necessarily indicative of the amounts the Company would realize in a current market exchange.
During the three months ended March 31, 2013, there were no changes to the Company valuation techniques that had, or are expected to have, a material impact on its condensed consolidated financial position or results of operations.
Assets and Liabilities Measured at Fair Value on a Recurring Basis.
Assets and liabilities measured at fair value on a recurring basis are as follows (dollars in millions):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Balance at March 31, 2013				
Assets				
U.S Treasury securities	$ 2,081	$ —	$ —	$ 2,081
U.S government agency securities	1,704	—	—	1,704
Credit card asset-backed securities of other issuers	—	108	—	108
Residential mortgage-backed securities - Agency	—	1,303	—	1,303
Available-for-sale investment securities	$ 3,785	$ 1,411	$ —	$ 5,196
Mortgage loans held for sale	$ —	$ 310	$ 1	$ 311
Interest rate lock commitments	$ —	$ —	$ 14	$ 14
Forward delivery contracts	—	1	—	1
Other derivative financial instruments	—	93	—	93
Derivative financial instruments	$ —	$ 94	$ 14	$ 108
Liabilities				
Forward delivery contracts	$ —	$ 2	$ —	$ 2
Other derivative financial instruments	—	1	—	1
Derivative financial instruments	$ —	$ 3	$ —	$ 3

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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Balance at December 31, 2012				
Assets				
U.S Treasury securities	$ 2,459	$ —	$ —	$ 2,459
U.S government agency securities	2,233	—	—	2,233
Credit card asset-backed securities of other issuers	—	151	—	151
Residential mortgage-backed securities - Agency	—	1,302	—	1,302
Available-for-sale investment securities	$ 4,692	$ 1,453	$ —	$ 6,145
Mortgage loans held for sale	$ —	$ 355	$ —	$ 355
Interest rate lock commitments	$ —	$ —	$ 12	$ 12
Forward delivery contracts	—	1	—	1
Other derivative financial instruments	—	98	—	98
Derivative financial instruments	$ —	$ 99	$ 12	$ 111
Liabilities				
Forward delivery contracts	$ —	$ 2	$ —	$ 2
Other derivative financial instruments	—	1	—	1
Derivative financial instruments	$ —	$ 3	$ —	$ 3
Balance at November 30, 2012				
Assets				
U.S Treasury securities	$ 2,462	$ —	$ —	$ 2,462
U.S government agency securities	2,237	—	—	2,237
Credit card asset-backed securities of other issuers	—	159	—	159
Corporate debt securities	—	75	—	75
Residential mortgage-backed securities - Agency	—	1,200	—	1,200
Available-for-sale investment securities	$ 4,699	$ 1,434	$ —	$ 6,133
Mortgage loans held for sale	$ —	$ 322	$ —	$ 322
Interest rate lock commitments	$ —	$ —	$ 15	$ 15
Forward delivery contracts	—	1	—	1
Other derivative financial instruments	—	116	—	116
Derivative financial instruments	$ —	$ 117	$ 15	$ 132
Liabilities				
Forward delivery contracts	$ —	$ 4	$ —	$ 4
Other derivative financial instruments	—	1	—	1
Derivative financial instruments	$ —	$ 5	$ —	$ 5

There were no transfers between Levels 1 and 2 within the fair value hierarchy during the three months ended March 31, 2013 and 2012, or the one month ended December 31, 2012.

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Available-for-sale investment securities. Investment securities classified as available-for-sale consist of U.S. Treasury and government agency securities, residential mortgage-backed securities, corporate debt and credit card asset-back securities issued by other financial institutions. The fair value estimates of investment securities classified as Level 1, consisting of U.S. Treasury and government agency securities, are determined based on quoted market prices for the same or similar securities. The Company classifies all other available-for-sale investment securities as Level 2, the fair value estimates of which are primarily obtained from pricing services, where fair values are estimated using pricing models based on observable market inputs or recent trades of similar securities. The fair value estimates of mortgage-backed and credit card asset-backed securities are based on the best information available. This data may consist of observed market prices, broker quotes or discounted cash flow models that incorporate assumptions such as benchmark yields, issuer spreads, prepayment speeds, credit ratings and losses, the priority of which may vary based on availability of information. The fair value estimates for corporate debt obligations issued under the Temporary Liquidity Guarantee Program are derived utilizing a spread relative to an underlying benchmark curve which reflects the terms and conditions of specific instruments being valued.

The Company validates the fair value estimates provided by the pricing services primarily by comparison to valuations obtained through other pricing sources. The Company evaluates pricing variances amongst different pricing sources to ensure that the valuations utilized are reasonable. The Company also corroborates the reasonableness of the fair value estimates with analysis of trends of significant inputs, such as market interest rate curves. The Company further performs due diligence in understanding the procedures and techniques performed by the pricing services to derive fair value estimates.

At March 31, 2013, amounts reported in credit card asset-backed securities issued by other institutions reflected senior-rated Class A securities having a par value of $101 million and more junior-rated Class B and Class C securities with par values of $6 million and $1 million, respectively. The Class A securities had a weighted-average coupon of 0.46% and a weighted-average remaining maturity of three months; the Class B, 0.40% and ten months, respectively; and the Class C, 0.60% and five months, respectively. The assets underlying these securities are predominantly prime general-purpose credit card loan receivables. Amounts reported in residential mortgage-backed securities reflect government-rated obligations issued by Fannie Mae, Freddie Mac and Ginnie Mae with a par value of $1.2 billion, a weighted-average coupon of 2.84% and a weighted-average remaining maturity of four years.

Mortgage loans held for sale and related derivative instruments. The Company enters into commitments with consumers to originate mortgage loans at a specified interest rate, known as interest rate lock commitments (“IRLCs”). The Company reports IRLCs as derivative instruments at fair value with changes in fair value being recorded in other income. IRLCs and mortgage loans held for sale under certain loan programs are hedged in aggregate using “to be announced mortgage-backed securities” (“TBA MBS”). IRLCs and mortgage loans held for sale under loan programs that generally have lower volume are hedged on an individual loan level using best-efforts forward delivery contracts. Fair values for each of these instruments are determined using quantitative risk models. The Company has various monitoring processes in place to validate these valuations, including valuations of Level 3 assets. Valuation results are reviewed in comparison to expected results, recent activity, and historical trends. Any significant or unusual fluctuations in value are analyzed.

- Mortgage loans held for sale. Valuations of mortgage loans held for sale are based on the loan amount, note rate, loan program, expected sale date of the loan and, most significantly, investor pricing tables stratified by product, note rate and term, adjusted for current market conditions. Mortgage loans held for sale are classified as Level 2 as the investor pricing tables used to value them are an observable input. Impaired mortgage loans held for sale are classified as Level 3 as loss severity is an unobservable input used in valuation. The Company recognizes interest income separately from changes in fair value.
- Interest rate lock commitments. IRLCs for loans to be sold to investors using a mandatory or assignment of trade method derive their base value from an underlying loan type with similar characteristics using the TBA MBS market, which is actively quoted and easily validated through external sources. The data inputs used in this valuation include, but are not limited to, loan type, underlying loan amount, note rate, loan program, and expected sale date of the loan. IRLCs for loans to be sold to investors on a best-efforts basis derive their base value from the value of the underlying loans using investor pricing tables stratified by product, note rate and term, adjusted for current market conditions.

These valuations are adjusted at the loan level to consider the servicing release premium and loan pricing adjustments specific to each loan. For all IRLCs, this base value is then adjusted for the anticipated loan funding probability, or pull through rate. The anticipated loan funding probability is an unobservable input based on historical experience, which results in classification of IRLCs as Level 3.

- Forward delivery contracts. Under the Company's risk management policy, the Company economically hedges the changes in fair value of IRLCs and mortgage loans held for sale caused by changes in interest rates by using TBA MBS

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and entering into best-efforts forward delivery contracts. These hedging instruments are recorded at fair value with changes in fair value recorded in other income. TBA MBS used to hedge both IRLCs and loans held for sale are valued based primarily on observable inputs related to characteristics of the underlying MBS stratified by product, coupon and settlement date. Therefore, these derivatives are classified as Level 2. Best-efforts forward delivery contracts are valued based on investor pricing tables, which are observable inputs, stratified by product, note rate, and term, adjusted for current market conditions. An anticipated loan funding probability is applied to value best-efforts contracts hedging IRLCs, which results in the classification of these contracts as Level 3. The current base loan price and, for best-efforts contracts hedging IRLCs, the anticipated loan funding probability, are the most significant assumptions affecting the value of the best-efforts contracts. The best-efforts forward delivery contracts hedging loans held for sale are classified as Level 2, so such contracts are transferred from Level 3 to Level 2 at the time the underlying loan is originated. For the purposes of the tables below, we refer to TBA MBS and best-efforts forward delivery contracts as forward delivery contracts.

Other derivative financial instruments. The Company's other derivative financial instruments consist of interest rate swaps and foreign currency forward contracts. The fair value of these instruments is estimated by a third-party valuation service that uses proprietary pricing models, where certain inputs to those models are readily observable market-based inputs, including interest rate curves, option volatility and foreign currency forward and spot rates. In determining fair values, the pricing models use widely accepted valuation techniques which may include discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity and uses observable market-based inputs. The fair values of the interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments are based on an expectation of future interest rates derived from observable market interest rate curves. The Company considers collateral and legally enforceable master netting agreements that mitigate credit exposure to counterparties in determining the counterparty credit risk valuation adjustment. The fair values of the currency instruments are valued comparing the contracted forward exchange rate pertaining to the specific contract maturities to the current market exchange rate.

The Company validates the fair value estimates of interest rate swaps primarily through comparison to the fair value estimates computed by the counterparty's to each of the derivative transactions. The Company evaluates pricing variances amongst different pricing sources to ensure that the valuations utilized are reasonable. The Company also corroborates the reasonableness of the fair value estimates with analysis of trends of significant inputs, such as market interest rate curves. The Company performs due diligence in understanding the impact to any changes to the valuation techniques performed by proprietary pricing models prior to implementation, working closely with the third-party valuation service, and reviews the control objectives of the service at least annually. The Company corroborates the fair value of foreign currency forward contracts through independent calculation of the fair value estimates.

Assets and liabilities under the fair value option. The Company has elected to account for mortgage loans held for sale at fair value. Electing the fair value option allows a better offset of the changes in fair values of the loans and the forward delivery contracts used to economically hedge them without the burden of complying with the requirements for hedge accounting. At March 31, 2013, December 31, 2012 and November 30, 2012, the aggregate unpaid principal balance of loans held for sale for which the fair value option had been elected was $299 million, $337 million and $305 million, respectively. At March 31, 2013, December 31, 2012 and November 30, 2012, the same loans had a fair value of $311 million, $355 million and $322 million, respectively. For the three months ended March 31, 2013 and the one month ended December 31, 2012, respectively, $6 million and $1 million of gains from fair value adjustments on mortgage loans held for sale were recorded in other revenue on the condensed consolidated statements of income. There were no loans held for sale accounted for under the fair value option at any time during the three months ended March 31, 2012.

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Level 3 Financial Instruments Only

The following tables provide changes in the Company’s Level 3 assets and liabilities measured at fair value on a recurring basis.

Changes in Level 3 Assets and Liabilities Measured at Fair Value on a Recurring Basis
(dollars in millions)

For the Three Months Ended March 31, 2013

	Balance at December 31, 2012	Transfers into Level 3	Transfers out of Level 3	Total net gains (losses) included in earnings	Purchases	Sales	Settlements	Transfers of IRLCs to closed loans	Balance at March 31, 2013
Interest rate lock commitments	$ 12	—	—	48	—	—	3	(49)	$ 14
Mortgage loans held for sale	$ —	1	—	—	—	—	—	—	$ 1

For the One Month Ended December 31, 2012

	Balance at November 30, 2012	Transfers into Level 3	Transfers out of Level 3	Total net gains (losses) included in earnings	Purchases	Sales	Settlements	Transfers of IRLCs to closed loans	Balance at December 31, 2012
Interest rate lock commitments	$ 15	—	—	17	—	—	1	(21)	$ 12

Unobservable inputs and sensitivities

The following table presents information about significant unobservable inputs related to the Company's Level 3 financial assets and liabilities measured at fair value on a recurring and non-recurring basis as of March 31, 2013 (dollars in millions):

	Fair Value	Valuation Technique	Significant Unobservable Input	Ranges of Inputs	
				Low	High
Interest rate lock commitments	$14	Quantitative risk models	Loan funding probability	20 %	95 %
Mortgage loans held for sale	$1	Market comparables	Loss severity	20 %	55 %

The anticipated loan funding probability represents the Company's expectation regarding the percentage of IRLCs that will ultimately be funded. Generally, an increase in the anticipated loan funding probability would result in an increase in the magnitude of fair value measurements.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis. The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include those associated with acquired businesses, including goodwill and other intangible assets. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if one or more is determined to be impaired. During the three months ended March 31, 2013 and 2012, and the one month ended December 31, 2012, the Company had no impairments related to these assets.

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Financial Instruments Measured at Other Than Fair Value

The following tables disclose the estimated fair value of the Company's financial assets and financial liabilities that are not required to be carried at fair value, as of March 31, 2013, December 31, 2012 and November 30, 2012 (dollars in millions):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Carrying Value
Balance at March 31, 2013					
Assets					
U.S Treasury securities	$ 1	$—	$—	$1	$1
States and political subdivisions of states	—	24	—	24	24
Residential mortgage-backed securities - Agency	—	51	—	51	49
Held-to-maturity investment securities	$ 1	$75	$—	$76	$74
Cash and cash equivalents	$ 8,067	$—	$—	$8,067	$8,067
Restricted cash	$ 482	$—	$—	$482	$482
Net loan receivables [(1)]	$ —	$—	$60,903	$60,903	$58,439
Accrued interest receivables	$ —	$505	$—	$505	$505
Liabilities					
Deposits	$ —	$42,814	$—	$42,814	$42,394
Short-term borrowings	$ —	$290	$—	$290	$290
Long-term borrowings - owed to securitization investors	$ —	$14,931	$2,310	$17,241	$16,744
Other long-term borrowings	$ —	$3,090	$2	$3,092	$2,486
Accrued interest payables	$ —	$145	$—	$145	$145

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Carrying Value
Balance at December 31, 2012					
Assets					
U.S Treasury securities	$ 1	$—	$—	$1	$1
States and political subdivisions of states	—	34	—	34	34
Residential mortgage-backed securities - Agency	—	54	—	54	52
Held-to-maturity investment securities	$ 1	$88	$—	$89	$87
Cash and cash equivalents	$ 2,584	$—	$—	$2,584	$2,584
Restricted cash	$ 290	$—	$—	$290	$290
Net loan receivables [(1)]	$ —	$—	$62,619	$62,619	$60,455
Accrued interest receivables	$ —	$500	$—	$500	$500
Liabilities					

Deposits	$ —	$42,671	$—	$42,671	$42,213
Short-term borrowings	$ —	$327	$—	$327	$327
Long-term borrowings - owed to securitization investors	$ —	$14,033	$2,337	$16,370	$15,933
Other long-term borrowings	$ —	$2,332	$2	$2,334	$1,733
Accrued interest payables	$ —	$126	$—	$126	$126

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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Carrying Value
Balance at November 30, 2012					
Assets					
U.S Treasury securities	$ 1	$ —	$ —	$1	$1
States and political subdivisions of states	—	34	—	34	34
Residential mortgage-backed securities - Agency	—	55	—	55	53
Held-to-maturity investment securities	$ 1	$ 89	$ —	$90	$88
Cash and cash equivalents	$ 3,926	$ —	$ —	$3,926	$3,926
Restricted cash	$ 2,344	$ —	$ —	$2,344	$2,344
Net loan receivables [(1)]	$ —	$ —	$ 61,378	$61,378	$58,970
Accrued interest receivables	$ —	$ 466	$ —	$466	$466
Liabilities					
Deposits	$ —	$ 42,630	$ —	$42,630	$42,155
Short-term borrowings	$ —	$ 284	$ —	$284	$284
Long-term borrowings - owed to securitization investors	$ —	$ 16,108	$ 2,353	$18,461	$17,995
Other long-term borrowings	$ —	$ 2,337	$ 2	$2,339	$1,734
Accrued interest payables	$ —	$ 128	$ —	$128	$128

(1) Net loan receivables excludes mortgage loans held for sale that are measured at fair value on a recurring basis.

The fair values of these financial assets and liabilities, which are not carried at fair value on the condensed consolidated statements of financial condition, were determined by applying the fair value provisions discussed herein. The use of different assumptions or estimation techniques may have a material effect on these estimated fair value amounts. The following describes the valuation techniques of these financial instruments measured at other than fair value.

Cash and cash equivalents. The carrying value of cash and cash equivalents approximates fair value due to the low level of risk these assets present to the Company as well as the relatively liquid nature of these assets, particularly given their short maturities.

Restricted cash. The carrying value of restricted cash approximates fair value due to the low level of risk these assets present to the Company as well as the relatively liquid nature of these assets, particularly given their short maturities.

Held-to-maturity investment securities. Held-to-maturity investment securities consist of residential mortgage-backed securities issued by agencies and municipal bonds. The fair value of residential mortgage-backed securities included in the held-to-maturity portfolio is estimated similarly to residential mortgage-backed securities carried at fair value on a recurring basis discussed herein. Municipal bonds are valued based on quoted market prices for the same or similar securities.

Total loan portfolio. The Company's loan receivables are comprised of credit card and installment loans, including the PCI student loans. Fair value estimates are derived utilizing discounted cash flow analyses, the calculations of which are performed on groupings of loan receivables that are similar in terms of loan type and characteristics. Inputs to the cash flow analysis of each grouping consider recent pre-payment and interest accrual trends and leverage forecasted loss estimates. The expected future cash flows of each grouping are discounted at rates at which similar loans within

each grouping could be made under current market conditions. Significant inputs to the fair value measurement of the loan portfolio are unobservable, and as such are classified as Level 3.
Accrued interest receivable. For the Company's accrued interest receivable, which is included in other assets on the statement of financial condition, the carrying value approximates fair value as it is short-term in nature and is due in less than one year.
Deposits. The carrying values of money market deposits, savings deposits and demand deposits approximate fair value due to the potentially liquid nature of these deposits. For time deposits for which readily available market rates do not exist, fair

values are estimated by discounting expected future cash flows using market rates currently offered for deposits with similar remaining maturities.

Short-term borrowings. The carrying values of short-term borrowings approximate fair value as they are short term in nature and have maturities of less than one year.

Long-term borrowings-owed to securitization investors. Fair values of long-term borrowings owed to credit card securitization investors are determined utilizing quoted market prices of the same transactions, and as such are classified as Level 2. Fair values of long-term borrowings owed to student loan securitization investors are calculated by discounting cash flows using estimated assumptions including, among other things, maturity and market discount rates. Significant inputs to these fair value measurements are unobservable, and as such, are classified as Level 3.

Other long-term borrowings. Fair values of other long-term borrowings, consisting of subordinated debt and unsecured debt, are determined utilizing current observable market prices for those transactions, and as such are classified as Level 2. A portion of the difference between the carrying value and the fair value of the subordinated debt relates to the cash premiums paid in connection with the second and fourth quarter debt exchanges as discussed in further detail in Note 7: Long-Term Borrowings. Fair values of other long-term borrowing for which there are no observable market transactions, namely capitalized leases, are determined by discounting cash flows of future interest accruals at market rates currently offered for borrowings with similar credit risks, remaining maturities and repricing terms. As the significant inputs to these fair value measurements are unobservable, they are classified as Level 3.

Accrued interest payable. The Company's accrued interest payable, which is included in other liabilities on the statement of financial condition, carrying value approximates fair value as it is short term in nature and is payable in less than one year.

15. Derivatives and Hedging Activities

The Company uses derivatives to manage its exposure to various financial risks. The Company does not enter into derivatives for trading or speculative purposes. Certain derivatives used to manage the Company’s exposure to interest rate movements and other identified risks are not designated as hedges and do not qualify for hedge accounting. All derivatives are recorded in other assets at their gross positive fair values and in accrued expenses and other liabilities at their gross negative fair values.

Derivatives may give rise to counterparty credit risk, which generally is addressed through collateral arrangements as described under the sub-heading "Collateral Requirements and Credit-Risk Related Contingency Features." The Company enters into derivative transactions with established dealers that meet minimum credit criteria established by the Company. All counterparties must be pre-approved prior to engaging in any transaction with the Company. Counterparties are monitored on a regular basis by the Company to ensure compliance with the Company’s risk policies and limits. In determining the counterparty credit risk valuation adjustment for the fair values of derivatives, the Company considers collateral and legally enforceable master netting agreements that mitigate credit exposure to counterparties.

Derivatives Designated as Hedges

Derivatives designated and qualifying as a hedge of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges. Derivatives designated and qualifying as a hedge of the exposure to changes in the fair value of an asset, liability, or firm commitment attributable to a particular risk, such as interest rate risk, are considered fair value hedges.

Cash Flow Hedges. The Company uses interest rate swaps to manage its exposure to changes in interest rates related to future cash flows resulting from credit card loan receivables. The Company's current cash flow hedges are for a maximum period of three years. The derivatives are designated as a hedge of the risk of overall changes in cash flows on the Company’s portfolios of prime-based interest receipts and qualify for hedge accounting in accordance with ASC Topic 815, Derivatives and Hedging (“ASC 815”).

The effective portion of the change in the fair value of derivatives designated as cash flow hedges is recorded in other comprehensive income and is subsequently reclassified into earnings in the period that the hedged forecasted cash flows affect earnings. The ineffective portion of the change in fair value of the derivative, if any, is recognized directly in earnings. Amounts reported in accumulated other comprehensive income related to derivatives at March 31, 2013

will be reclassified to interest income as interest payments are received on certain of the Company's floating rate credit card loan receivables. During the next 12 months, the Company estimates it will reclassify to earnings $2 million of pretax gains related to its derivatives designated as cash flow hedges.

Fair Value Hedges. The Company is exposed to changes in fair value of certain of its fixed rate debt obligations due to changes in interest rates. During the three months ended March 31, 2013, the Company used interest rate swaps to manage its

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exposure to changes in fair value of certain fixed rate senior notes, securitized debt and interest-bearing brokered deposits attributable to changes in LIBOR, a benchmark interest rate as defined by ASC 815. The interest rate swaps involve the receipt of fixed rate amounts from the respective counterparties in exchange for the Company making payments of variable rate amounts over the life of the agreements without exchange of the underlying notional amounts. These interest rate swaps qualify as fair value hedges in accordance with ASC 815. Changes in both (i) the fair values of the derivatives and (ii) the hedged fixed rate senior notes, securitized debt and interest-bearing brokered deposits relating to the risk being hedged were recorded in interest expense. The changes provided substantial offset to one another. Ineffectiveness related to these fair value hedges was recorded in interest expense. Any basis differences between the fair value and the carrying amount of the hedged fixed rate senior notes, securitized debt and interest-bearing brokered deposits at the inception of the hedging relationship is amortized and recorded in interest expense.

Derivatives Not Designated as Hedges

Interest rate lock commitments. The Company enters into commitments with consumers to originate loans at a specified interest rate. The Company reports IRLCs as derivative instruments at fair value with changes in fair value recorded in other income.

Forward delivery contracts. The Company economically hedges the changes in fair value of IRLCs and mortgage loans held for sale caused by changes in interest rates by using TBA MBS and entering into best efforts forward delivery commitments. These hedging instruments are recorded at fair value with changes in fair value recorded in other income.

Interest rate swaps. The Company also may have from time to time interest rate swap agreements that are not designated as hedges. As part of its acquisition of SLC, the Company also acquired an interest rate swap related to the securitized debt assumed in the SLC transaction. Such agreements are not speculative and are also used to manage interest rate risk but are not designated for hedge accounting. Changes in the fair value of these contracts are recorded in other income.

Foreign exchange forward contracts. The Company has foreign exchange forward contracts that are economic hedges and are not designated as hedges for accounting purposes. The Company enters into foreign exchange forward contracts to manage foreign currency risk. Foreign exchange forward contracts involve the purchase or sale of a designated currency at an agreed upon rate for settlement on a specified date. Changes in the fair value of these contracts are recorded in other income.

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The following table summarizes the fair value (including accrued interest) and related outstanding notional amounts of derivative instruments and indicates where within the statement of financial condition each is reported as of March 31, 2013, December 31, 2012 and November 30, 2012. See Note 14: Fair Value Disclosures for a description of the valuation methodologies of derivatives (dollars in millions):

	March 31, 2013				December 31, 2012		
			Balance Sheet Location			Balance Sheet Location	
	Notional Amount	Number of Transactions	Other Assets (At Fair Value)	Accrued Expenses and Other Liabilities (At Fair Value)	Notional Amount	Other Assets (At Fair Value)	Accrued Expenses and Other Liabilities (At Fair Value)
Derivatives designated as hedges:							
Interest rate swaps—cash flow hedge	$1,750	7	$3	$—	$1,750	$5	$—
Interest rate swaps—fair value hedge	$7,956	285	$90	$—	$7,859	$93	$—
Derivatives not designated as hedges:							