Discover Financial Services
Form 10-K
January 28, 2010
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended November 30, 2009

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

For the transition period from to

CommissionFile Number 001-33378

DISCOVER FINANCIAL SERVICES

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x

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

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

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

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

The aggregate market value of the common equity held by non-affiliates of the registrant on the last business day of the registrant s most recently completed second fiscal quarter was approximately $4,591,686,556.

As of January 15, 2010, there were 543,609,676 shares of the registrant s Common Stock, par value $0.01 per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive proxy statement for its annual stockholders meeting to be held on April 8, 2010 are incorporated by reference in Part III of this Form 10-K.

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DISCOVER FINANCIAL SERVICES

Annual Report on Form 10-K for the year ended November 30, 2009

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

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

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Part I. | Item 1. Business

Introduction

Discover Financial Services is a leading credit card issuer in the United States and an electronic payment services company. In March 2009, we became a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act in connection with our participation in the U.S. Treasury s Capital Purchase Program (CPP). Therefore, we are now subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve).

We offer credit cards, personal and student loans, and deposit products. At November 30, 2009, we had $50.9 billion in managed receivables and $12.6 billion in deposits issued through direct-to-consumer channels and affinity relationships. We operate the Discover Network, our credit card payments network; the PULSE Network (PULSE), our automated teller machine (ATM), debit and electronic funds transfer network; and Diners Club International (Diners Club), our global payments network. As we continue to work toward achieving card acceptance across our networks, we expect Discover customers to be able to use their cards at merchant and ATM locations that accept Diners Club cards in a growing number of countries around the world and Diners Club customers to be able to use their cards on the Discover Network in North America and on the PULSE Network domestically and internationally.

Our business segments are Direct Banking, formerly referred to as U.S. Card, and Payment Services, formerly referred to as Third-Party Payments. We have changed the names of our segments to better reflect the nature of the products and services included in our segments. The composition of each segment, however, has not changed. Our Direct Banking segment includes our credit cards issued to individuals and small businesses on the Discover Network, our other consumer lending products and our deposit products. Our Payment Services segment includes PULSE, Diners Club and our third-party issuing business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties.

Available Information

We are required to file annual, quarterly and current reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended (the Exchange Act), with the Securities and Exchange Commission (the SEC). You may read and copy any document we file with the SEC at the SEC s Public Reference Room located at 100 F Street, N.E., Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an internet website at *http://www.sec.gov*, from which interested persons can electronically access our SEC filings.

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

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

Operating Model

We manage our business activities in two segments: Direct Banking, formerly referred to as U.S. Card, and Payment Services, formerly referred to as Third-Party Payments. For additional financial information relating to our business and our operating segments, see Note 25: Segment Disclosures to our consolidated financial statements. We are principally engaged in providing products and services to customers in the United States, although the royalty revenue we receive from Diners Club licensees is derived from sources outside of the United States. For quantitative information concerning

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our geographic distribution, see Note 5: Loan Receivables to our consolidated financial statements and for quantitative information concerning our royalty revenue, see Note 18: Other Income and Other Expense.

Below are descriptions of the principal products and services of each of our reportable segments.

Direct Banking

Our Direct Banking segment, formerly referred to as our U.S. Card segment, includes Discover card-branded credit cards issued to individuals and small businesses on the Discover Network and other consumer products and services, including personal loans, student loans, prepaid cards and other consumer lending and deposit products offered through our Discover Bank subsidiary.

Credit Cards

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

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

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

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

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Installment Loans

In addition to credit cards, we offer installment loans, including personal loans and student loans. We have grown our installment loans significantly, from $1.4 billion at November 30, 2008 to $3.4 billion at November 30, 2009. We offer our installment loans to new and existing customers online, by phone and by mail.

Our personal loans are unsecured loans with fixed interest rates, fixed terms and fixed payments, and are primarily intended to help customers consolidate existing debt, although they can be used for any reason. In addition to the interest earned on our personal loans, we also earn loan origination fees on some of our personal loans and fees from customers that enroll in our payment protection product. We generally market our personal loan products to our credit card customers, although we also market personal loans more broadly. Our student loans include federal and private loans that help students and parents finance the costs of attending post-secondary educational institutions. Our federal student loans are available to cover education costs at schools that participate in the U.S. government s Federal Family Education Loan Program (FFELP), and are 97% guaranteed by the federal government. Our private student loans are available to cover education costs at select schools offering undergraduate and graduate degree programs and are available to students with or without a cosigner. All of our private student loans are certified by schools as part of the approval process to prevent over-borrowing and are disbursed through schools to ensure proper use of loan funds.

Deposit Products

We offer deposit products, including certificates of deposit, money market accounts, online savings accounts and Individual Retirement Account (IRA) certificates of deposit, to customers through two channels: (i) directly through direct mail, internet origination and affinity relationships (direct-to-consumer deposits); and (ii) indirectly through contractual arrangements with brokerage firms (brokered deposits).

In 2009, we significantly increased our direct-to-consumer deposits to $12.6 billion at November 30, 2009, up from $6.2 billion at November 30, 2008, and we expect to continue to grow our use of this deposit channel in 2010. We maintain a dedicated deposit products call center and an internet site to allow prospective and existing customers to apply for, fund and service their accounts. We market our deposit products to our credit card customers and also use industry rate comparison web sites, paid search campaigns, print advertising and affinity arrangements to offer our deposit products to prospective customers. As of November 30, 2009, 41% of our direct-to-consumer deposit account holders were also credit card customers. For more information regarding our deposit business, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Funding Sources Deposits.

Payment Services

Our Payment Services segment, formerly referred to as our Third-Party Payments segment, includes PULSE, our ATM, debit and electronic funds transfer network; Diners Club, our global payments network; and our third-party issuing business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties.

PULSE Network

The PULSE Network is one of the nation s leading ATM/debit networks. PULSE links cardholders of more than 4,400 financial institutions with ATMs and point-of-sale (POS) terminals located throughout the United States. Beginning in 2009, PULSE also provides cash access at an increasing number of ATMs in over 30 countries. PULSE s primary source of revenue is transaction fees charged for switching and settling ATM, personal identification number (PIN) POS debit and signature debit transactions initiated through the use of debit cards issued by participating financial institutions. In addition, PULSE offers a variety of optional products and services that produce income for the network, including signature debit processing, prepaid card processing, and connections to other regional and national electronic funds transfer networks.

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

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Diners Club

Our Diners Club business maintains an acceptance network in over 185 countries and territories through its relationships with 79 licensees, which are generally financial institutions. Diners Club itself does not directly issue credit cards to consumers, but grants its licensees the right to issue Diners Club branded credit cards and/or provide card acceptance services. Our licensees pay us royalties for the right to use the Diners Club brand, which is our primary source of Diners Club revenues. Diners Club also earns revenue from providing various support services to its licensees, including processing and settlement of cross border transactions. Diners Club also offers licensees a centralized service center and internet services.

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

Third-Party Issuing Business

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

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

The discussion below provides additional detail around the supporting functions of our two segments. The consumer lending, deposit and other consumer products issued through our Direct Banking segment, formerly referred to as our U.S. Card segment, require significant investments in credit risk management, marketing, and customer assistance and customer service, whereas the operation of the Discover Network and our Payment Services business requires that we invest in technology as well as relationships with issuers, merchants and merchant acquirers.

Credit Risk Management Lending Products

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

New Customers (Account Acquisition)

We acquire new customers either through targeted marketing efforts or through unsolicited individual applications. In either case, we have a rigorous process for screening applicants. In terms of identifying potential customers, our credit risk management team uses proprietary targeting and analytical models to identify credit-worthy prospects and our marketing team matches them with our product offerings. We give consideration to the prospective customer s financial stability, as well as ability and willingness to pay. We employ multiple acquisition channels, including direct mail, internet, print advertising and telemarketing. Direct mail has historically accounted for the greatest proportion of our new consumer accounts, representing more than half of all new accounts acquired in 2009. In order to make the best use of our human and monetary resources used to acquire new accounts, we seek out production efficiencies, conduct creative testing and aim to continuously improve our product offerings and enhance our targeting and analytical models.

We assess the creditworthiness of each applicant through our underwriting process. We evaluate prospective customers applications using credit information provided by the credit bureaus and other sources. We use credit scoring systems, both externally developed and proprietary, to evaluate customer and credit bureau data. We use experienced credit underwriters to supplement our automated decision-making processes. Approximately 20% of all credit card applications are subject to manual review that covers the areas of key customer data verification, fraud prevention and approval of credit lines.

Upon approval of a customer s application, we assign a credit line based on risk level, income and expected card usage, and assign specific annual percentage rates (APRs) and terms for different customers and products. In determining the APR, we use an analytical pricing strategy that provides competitive pricing for customers and seeks to maximize revenue on a risk-adjusted basis.

Existing Customers (Portfolio Management)

Proactive management of a customer s account is a critical part of credit risk management, and all accounts are subject to ongoing credit assessment. This assessment reflects information relating to the performance of the individual s Discover account as well as information from credit bureaus relating to the customer s broader credit performance. We utilize scoring models (statistical evaluation models) to support the measurement and management of credit risk. At the individual customer level, we use custom risk models together with generic industry models as an integral part of the credit decision-making process.

Depending on the duration of the customer s account, risk profile and other performance metrics, the account may be subject to a range of account management treatments, including eligibility for marketing initiatives, limits on transaction authorization, and increases or decreases in purchase and cash credit limits.

Marketing

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

Product Development and Customer Management

In order to attract and retain customers and merchants, we continue to develop new products, features, and benefits and market them through a variety of channels, including mail, phone and online. Targeted offers may include balance transfers, fee products and reinforcement of our *Cashback Bonus* rewards program. Through the development of a large

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prospect database, use of credit bureau data and use of a customer contact strategy and management system, we have been able to improve our modeling and customer engagement capabilities, which help us offer the right products and pricing at the right time and through the right channels.

Rewards/Cashback Bonus

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

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

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

Discover Motiva card provides customers with a full month s interest as a reward each time they make six consecutive on-time payments.

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

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

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

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

Customers who are not delinquent or otherwise disqualified may redeem *Cashback Bonus* rewards at any time starting at $20 for Discover gift cards, partner gift cards or charitable donations to select charities. Customers also have the option to choose to redeem their *Cashback Bonus* awards for a statement credit or direct deposit to a bank account starting at and in increments of $50. Customers have the opportunity to increase their reward, up to double the reward amount, when they redeem for a brand name gift card from over 100 merchant partners.

Fee Products

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

Identity Theft Protection. The most comprehensive identity theft monitoring service we offer includes an initial credit report, credit bureau report monitoring, prompt alerts that help customers spot possible identity theft quickly, and access to knowledgeable professionals who can provide information about identity theft issues or credit reports.

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

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

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

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Credit Card Customer Website

Credit card customers can register their accounts online at *http://www.discover.com*, which offers a range of benefits and control features that allow them to customize their accounts to meet their own preferences and needs. Key offerings include:

- Online account services that allow customers to customize their accounts, choose how and when they pay their bills, create annual account summaries that assist them with budgeting and taxes, research transaction details and initiate transaction disputes;
- Email reminders to help customers avoid fees and track big purchases or returns;
- Money management tools like the Spend Analyzer, Paydown Planner and Purchase Planner;
- Secure online account numbers that let customers shop online without ever revealing their actual account numbers;
- A listing of third-party providers offering customers auto, homeowner s and term life insurance as well as home warranty plans; and
- ShopDiscover, an online portal where customers automatically earn 5 20% *Cashback Bonus* when they shop at well-known online merchants using their Discover card.

Brand and Advertising Management

We maintain a full-service, in-house direct marketing department charged with delivering integrated communications to foster customer engagement with our products and services in addition to supervising external agencies. Our brand team utilizes consumer insights to define our mass communication strategy, which informs our advertising decisions.

Customer Assistance and Customer Service

We maintain dedicated customer service centers and provide such services to our customers as monitoring and authorizing transactions and assisting delinquent customers in becoming current.

Authorizations

Each transaction is subject to screening and approval through a proprietary POS decision system. This system utilizes rules-based decision-making logic, statistical models and data integrity checks to manage fraud and credit risks. Strategies are subject to regular review and enhancement to enable us to respond quickly to changing credit conditions as well as to protect our customers and our business from emerging fraud activity.

Fraud Prevention

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

Our fraud detection program utilizes a variety of systems and techniques to identify and halt fraudulent transactions, including neural network and pattern recognition technology, rules-based decision-making logic, report analysis and manual account reviews. Accounts identified by the fraud detection system are managed by proprietary software that integrates effective fraud prevention with customer centric service.

Proactive Account Management

We use a variety of collection and recovery strategies, with overdue delinquent accounts scored and segmented to tailor the collection approach. We employ call campaigns, payment email reminders, flexible payment plans and a collections website designed to educate customers and assist them with their payment needs.

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

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risk accounts, as determined by statistically derived predictive models, telephone contacts may begin as soon as the account becomes past due. Lower risk customers are typically contacted by letter and further collection efforts are determined by behavioral scoring, financial exposure and the lateness of the payment.

We reevaluate our collection efforts and consider the implementation of other techniques, including internal collection activities, use of collections agencies and legal action, as a customer becomes increasingly delinquent. The timing and choice of channel utilized are subject to a recovery optimization strategy that encompasses factors such as cost and duration against expected recovery effectiveness. We limit our exposure to delinquencies through controls within the authorizations system and criteria based account suspension and revocation. In situations involving customers with financial difficulties, we may enter into arrangements to extend or otherwise change payment schedules, lower their interest rates and/or waive fees to aid customers in becoming current on their obligations to us. These arrangements are designed to help bring accounts out of delinquency or overlimit exposure.

Credit card loans are charged off at the end of the month during which an account becomes 180 days contractually past due. The only exceptions are bankrupt accounts, deceased customers, accounts on payment hardship or settlement programs, and fraudulent transactions, which are charged off earlier.

Customer Service

We currently manage over 80 million annual inbound customer service requests through calls placed to 1-800-Discover and inquiries through self-service channels such as chat, e-mail and interactive voice response. For calls placed to 1-800-Discover, we seek to answer calls within 60 seconds or less and to provide one-call resolution.

We perform the functions required to service and operate customers credit accounts, application processing, new account fulfillment, transaction authorization and processing, customer billing, payment processing, customer service and collection of delinquent accounts. We also work closely with some external vendors to solicit new account applications and to cross sell products. We believe that close management of these functions reduces our customer attrition and is cost-effective.

Designed around customer and account manager needs, our technology and systems enable our account managers to quickly access information in a manner that supports accurate and timely resolution of inquiries. We develop and maintain our infrastructure solutions with the flexibility to adapt quickly to meet customer expectations and needs. In addition to our systems, we invest in our people, providing them with the training and work environment that facilitates their ability to build strong customer relationships.

Processing Services

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

Discover Card Terms and Conditions

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

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

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

Each customer with an outstanding debit balance in his or her consumer Discover card account must generally make a minimum payment each month. If a customer exceeds his or her credit limit as of the last day of the billing period, we may include all or a portion of this excess amount in the customer s minimum monthly payment. From time to time, we have offered and may continue to offer eligible customers the opportunity not to make the minimum monthly payment, while continuing to accrue periodic finance charges, without being considered past due. A customer may pay the total amount due at any time. We also may enter into arrangements with delinquent customers to extend or otherwise change payment schedules, and to waive finance charges, fees and/or principal due, including re-aging accounts in accordance with regulatory guidance. Our income may be reduced during any period in which we offer customers the opportunity not to make the minimum monthly payment or to extend or change payment schedules.

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

We use the average daily balance method for determining periodic finance charges for Discover card accounts. The average daily balance method means that, subject to the grace period for new purchases, we impose periodic finance charges on the average daily balance of a customer s card account for the current billing cycle.

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

Discover Network Operations

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

We have chosen to retain direct relationships with most of our largest merchant accounts because many prefer dealing with us directly, we are able to retain the entire discount revenue from the merchant, and we are able to capitalize on joint marketing programs and opportunities. Competitor networks and credit card issuers typically do not enjoy direct relationships with merchants. The terms of our direct merchant relationships are governed by a merchant services agreement. These agreements also are accompanied by additional program documents that further define our network functionality and requirements, including operating regulations, technical specifications and dispute rules. To enable ongoing improvements in our network s functionality and in accordance with industry convention, we publish updates to our program documents on a semi-annual basis.

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

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

Technology

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

Our approach to technology development and management involves both third-party and in-house resources. We use third-party vendors for basic technology services (e.g., telecommunications, hardware and operating systems). We subject each vendor to a formal selection process to ensure that the vendor can assist us in maintaining a cost-effective and reliable technology platform. This approach enables us to focus our in-house resources on building proprietary systems (e.g., for customer and merchant settlement, authorizations and customer relationship management) that we believe enhance our operations, improve cost efficiencies and help distinguish us in the marketplace.

Seasonality

Although we experience fluctuations in our sales and transaction volumes related to seasonal changes in consumer spending patterns, our results of operations are not significantly impacted by seasonality.

Competition

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

We have increasingly offered our customers other lending products, including personal and student loans, although our credit card receivables continue to represent substantially all of our managed receivables (93% and 97% at November 30, 2009 and 2008, respectively). Some of our competitors offer a wider variety of loan products than we do, including automobile and home loans, which may position them better among customers who prefer to use a single financial institution to meet all of their financial needs. There has been a trend toward consolidation among credit card issuers, leading to greater concentration of resources. Some of our competitors enjoy greater capital resources than we do, and are therefore able to invest more in initiatives to attract and retain customers, such as advertising, targeted marketing, account acquisitions and pricing competition in interest rates, annual fees, reward programs and low-priced balance transfer programs.

Because most domestically issued credit cards, other than those issued on the American Express network, are issued on the Visa and MasterCard networks, most other card issuers benefit from the dominant marketing position and pricing

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power of Visa and MasterCard. The former exclusionary rules of Visa and MasterCard limited our ability to attract merchants and credit and debit card issuers, contributing to Discover not being as widely accepted in the U.S. as Visa and MasterCard. Merchant acceptance of the Discover card, however, has increased recently and we are making investments to further grow acceptance both domestically and internationally.

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

In our deposits business, we compete with other deposit-taking organizations such as banks and credit unions that source deposits through electronic and internet delivery channels or through branch locations. We compete in the deposit markets on the basis of pricing, reputation and convenience. We seek to obtain the deposits of new customers as well as existing Discover credit card customers by offering attractive rates and marketing our name brand.

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

Intellectual Property

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

Employees

As of January 15, 2010, we employed approximately 10,500 individuals.

Risk Management

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

Enterprise Risk Management Principles

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

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

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

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

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

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

Risk Management Roles and Responsibilities

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

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

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

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

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

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

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

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

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

Risk Appetite and Strategic Limit Structure

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

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

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

Risk Management Review of Compensation

In compliance with requirements of the CPP, our Corporate Risk Officer reviewed and discussed compensation arrangements with the Compensation Committee of our board of directors to ensure that these arrangements would not incent employees to take unnecessary or excessive risks that would threaten the value of the company or encourage the manipulation of reported earnings of the company to enhance the compensation of any employee.

Risk Categories

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

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

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

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

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

Liquidity Risk. Liquidity risk is the potential that we will be unable to meet our obligations as they come due because of an inability to obtain adequate funding or liquidate assets without significantly lowering market prices because of inadequate market depth or market disruptions. Liquidity risk exposures are managed through our Asset/Liability Management Committee. The responsibilities of our Asset/Liability Management Committee include (i) providing oversight and approval for liquidity risk and funding management strategies implemented by Corporate Treasury and ensuring that these strategies are consistent with our overall asset/liability management strategy, risk appetite and strategic limits; and (ii) reviewing and approving limits for managing liquidity and funding.

Operational Risk. Operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or external events will result in reputational harm or losses. Model risk, which is a part of operational risk, arises in our businesses and encompasses various operational risk sub-categories. We further differentiate operational risk into the following sub-categories: theft and fraud; employment practices and workplace safety; customer, products and business practices; technology; physical asset and data security; processing; financial and reporting; and external provider.

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

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

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

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

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

Supervision and Regulation

General

Our operations are subject to extensive regulation, supervision and examination under U.S. federal, state and foreign laws and regulations. On March 13, 2009, we became a bank holding company under the Bank Holding Company Act of 1956 (BHC Act) and a financial holding company under the Gramm-Leach-Bliley Act (GLBA), subject to the supervision, examination and regulation of the Federal Reserve Board (Federal Reserve).

Permissible activities for a bank holding company include those activities that are so closely related to banking as to be a proper incident thereto such as consumer lending and other activities that have been approved by the Federal Reserve by regulation or order. Certain servicing activities are also permissible for a bank holding company if conducted for or on behalf of the bank holding company or any of its affiliates. Impermissible activities for bank holding companies include activities that are related to commerce such as retail sales of nonfinancial products.

We elected to become a financial holding company under GLBA at the time that we became a bank holding company. The GLBA removed many of the restrictions on the activities of bank holding companies that become financial holding companies. A financial holding company, and the non-bank companies under its control, is permitted to engage in activities considered financial in nature; incidental to financial activities; or complementary to financial activities if the Federal Reserve determines that they pose no risk to the safety or soundness of depository institutions or the financial system in general.

Our election to become a financial holding company under the GLBA certifies that the depository institutions that we control meet certain criteria, including capital, management and Community Reinvestment Act requirements. If we were to fail to continue to meet the criteria for financial holding company status, we could, depending on which requirements we failed to meet, face restrictions on new financial activities or acquisitions and/or be required to discontinue existing activities that are not generally permissible for bank holding companies.

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

In addition, as a participant in the CPP, we are subject to specific restrictions under the terms of the CPP, including limits on our ability to pay dividends (quarterly dividends on our common stock are limited to $0.06 per share or less) and repurchase our capital stock, limits on executive compensation, and increased oversight by the U.S. Treasury, regulators and Congress under the Emergency Economic Stabilization Act of 2008, as amended (EESA). For details regarding these restrictions, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Liquidity and Capital Resources U.S. Treasury Capital Purchase Program.

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Banking Subsidiaries

We operate two banking subsidiaries, each of which is in the United States. Discover Bank offers credit card loans, student loans and personal loans, as well as checking accounts, certificates of deposit and money market accounts. It does not offer commercial loans other than business credit cards. Discover Bank is chartered and regulated by the Office of the Delaware State Bank Commissioner (the Delaware Commissioner) and the Federal Deposit Insurance Corporation (FDIC), which insures its deposits and serves as the bank s federal banking regulator. Our other bank, Bank of New Castle, is chartered and regulated by the Delaware Commissioner and the FDIC, which also insures its deposits.

Dividends

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

Capital

We, Discover Bank and Bank of New Castle are subject to capital adequacy guidelines adopted by federal banking regulators. For a further discussion of the capital adequacy guidelines, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources. As a bank holding company, we are required to maintain minimum capital ratios. Currently, we are required to maintain Tier 1 and total capital equal to at least 4% and 8% of our total risk-weighted assets, respectively. We are also required to maintain a minimum leverage ratio (Tier 1 capital to adjusted total assets) of 4% to 5%, depending upon criteria defined and assessed by the Federal Reserve. At November 30, 2009, Discover Financial Services met all requirements to be deemed well-capitalized.

FDIA

The Federal Deposit Insurance Act (the FDIA) imposes various requirements on insured depository institutions. For example, the FDIA requires, among other things, the federal banking agencies to take prompt corrective action in respect of depository institutions that do not meet minimum capital requirements. The FDIA sets forth the following five capital tiers: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. A depository institution s capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors that are established by regulation. At November 30, 2009, Discover Bank and Bank of New Castle met all applicable requirements to be deemed well-capitalized. Recent regulations proposed by the U.S. bank regulators, referred to as the Basel II proposal, could alter the capital adequacy framework for participating banking organizations. We will continue to closely monitor developments on these matters and assess their impact on us and our banking subsidiaries.

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

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

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

The FDIA prohibits a bank from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in its normal market area or nationally (depending upon where the deposits are solicited),

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unless (1) it is well-capitalized or (2) it is adequately capitalized and receives a waiver from the FDIC. A bank that is adequately capitalized and that accepts brokered deposits under a waiver from the FDIC may not pay an interest rate on any deposit in excess of 75 basis points over certain prevailing market rates. There are no such restrictions on a bank that is well-capitalized. As of November 30, 2009, Discover Bank and Bank of New Castle each met the FDIC s definition of a well-capitalized institution for purposes of accepting brokered deposits. An inability to accept brokered deposits in the future could materially adversely impact our funding costs and liquidity. For more information, see Risk Factors *An inability to accept or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business.*

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

Investment in Discover

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

Consumer Lending Regulation

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

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

The Credit Card Accountability Responsibility and Disclosure Act of 2009 (the CARD Act) was enacted in May 2009. The CARD Act makes numerous changes to the Truth in Lending Act, affecting the marketing, underwriting, pricing, billing and other aspects of the consumer credit card business. Several provisions of the CARD Act became effective in August 2009, but most of the requirements will become effective in February 2010 and others will become effective in August 2010. Legislation has been proposed to accelerate the effective date of all of the CARD Act provisions effective as soon as the legislation is enacted, but prospects for enactment are uncertain. For more information, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Risk Factors *The Credit Card Accountability Responsibility and Disclosure Act of 2009 will significantly impact our business practices and our results of operations.*

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The financial services industry, in general, is heavily regulated. Proposals for legislation further regulating the financial services industry are continually being introduced in the U.S. Congress and in state legislatures. Congress is considering extensive changes to the laws regulating financial services firms, including bills that address risks to the economy and the payments system through a variety of measures. Legislation approved in the House in December 2009, and a similar measure under consideration in the Senate, propose a new independent Consumer Financial Protection Agency (CFPA) that would regulate consumer financial services and products, including credit, savings and payment products. For further information regarding proposed reforms affecting the financial services industry and other recent legislative and regulatory developments that may impact our business, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Risk Factors *Laws, regulations, and supervisory guidance and practices, or the application thereof, may adversely affect our business, financial condition and results of operations.*

Electronic Funds Networks; Data Privacy

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

Money Laundering & Terrorist Financing Prevention Program

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

Sanctions Programs

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

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Executive Officers of the Registrant

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

Name	Age	Position
David W. Nelms	48	Chairman and Chief Executive Officer
Roger C. Hochschild	45	President and Chief Operating Officer
Roy A. Guthrie	56	Executive Vice President, Chief Financial Officer and Treasurer
Kathryn McNamara Corley	49	Executive Vice President, General Counsel and Secretary
Carlos Minetti	47	Executive Vice President, Cardmember Services and Consumer Banking
Diane E. Offereins	52	Executive Vice President, Payment Services
James V. Panzarino	57	Executive Vice President and Chief Credit Risk Officer
Glenn Schneider	48	Senior Vice President and Chief Information Officer
Harit Talwar	49	Executive Vice President, Card Programs and Chief Marketing Officer

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

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

Roy A. Guthrie has served as Executive Vice President and Chief Financial Officer since 2005 and as Treasurer since January 2009. Prior to joining us, Mr. Guthrie was President, Chief Executive Officer of CitiFinancial International, LTD, a Consumer Finance Business of Citigroup, from 2000 to 2004. In addition Mr. Guthrie served on Citigroup s Management Committee during this period of time. Mr. Guthrie served as Chief Financial Officer of Associates First Capital Corporation from 1996 to 2000, while it was a public company and served as a member of its board from 1998 to 2000. Mr. Guthrie holds a Bachelor s degree in Economics from Hanover College and an M.B.A. from Drake University.

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

Carlos Minetti has served as Executive Vice President, Cardmember Services and Consumer Banking since September 2006. Prior thereto, he had been Executive Vice President, Cardmember Services since January 2001 and Executive Vice President, Cardmember Services and Risk Management since January 2003. Prior to joining us, Mr. Minetti worked in card operations and risk management for American Express from 1987 to 2000, most recently as Senior Vice President. Mr. Minetti holds a Bachelor s of Science degree in Industrial Engineering from Texas A & M University and an M.B.A. from the University of Chicago.

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

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

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

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

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Item 1A. Risk Factors

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

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

Risks Related to the Current Environment and Recent Developments

The continued global economic downturn and financial market instability have had and could continue to have a material adverse effect on our business, results of operations, financial condition, access to funding and the trading price of our common stock.

The continued global economic downturn and financial market instability have adversely affected unemployment rates, consumer spending, consumer indebtedness, availability of consumer credit, asset values, investments and liquidity. These factors, along with an already high level of consumer indebtedness, have adversely affected the ability and willingness of customers to pay amounts owed to us. This environment has resulted in increased delinquencies and charge-offs. The owned over 30 days delinquent rate was 4.92% at November 30, 2009, up from 4.35% at November 30, 2008, and the full-year owned net charge-off rate was 7.45% for 2009, up from 4.59% for 2008. The economic downturn may continue, unemployment may remain elevated or rise, home values may continue to be depressed and consumer credit availability may continue to decrease. The ability and willingness of customers to pay amounts owed to us could continue to be adversely affected, which would further increase delinquencies and charge-offs and materially adversely affect our profitability. In addition, the deterioration in economic conditions could reduce the usage of our cards, the number of transactions on our cards and the average purchase amount of transactions on our cards, which would reduce transaction fees and interest income and thereby adversely affect profitability. We rely heavily on our credit card business to generate earnings. Our interest income for credit card loans was $2.8 billion for the 2009 fiscal year. Excluding settlement payments received from Visa, this was 59% of revenues (defined as net interest income plus other income).

Deterioration in the global capital markets has led to concerns by market participants about the stability of financial markets generally and the strength of counterparties, resulting in a contraction of available credit. Although we raised funds in capital market issuances in the third and fourth quarters of 2009, there is no assurance that the markets will be open to us in the future. In addition, it is uncertain whether the securitization markets will be available on terms or volumes that are attractive to us going forward, particularly after the Federal Reserve s Term Asset-Backed Securities Loan Facility Program (TALF) ends in March 2010. See *If we do not securitize our receivables, it may have a material adverse effect on our liquidity, cost of funds and overall financial condition*. Therefore, we continue to emphasize deposits as an ongoing funding source. See *An inability to accept or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business*. Further deterioration of the financial markets could materially adversely affect our capital, funding and liquidity position as well as our overall financial condition.

These macroeconomic trends affect key drivers of our results, including our loan balances outstanding, credit losses (including provisions and charge-offs) and cost of funding. These trends may cause our earnings and margins to fluctuate from quarter to quarter and diverge from expectations of analysts and investors, who may have differing assumptions regarding their impact on our business, and may impact the trading price of our common stock.

The Credit Card Accountability Responsibility and Disclosure Act of 2009 will significantly impact our business practices and our results of operations.

The Credit Card Accountability Responsibility and Disclosure Act of 2009, or the CARD Act, requires us to make fundamental changes to many of our current business practices, including marketing, underwriting, pricing and billing. For example, we currently have the ability to increase interest rates on existing balances to respond to market conditions and credit risk. The CARD Act will restrict our ability to manage market and individual risk in this manner. Restrictions on our ability to reprice accounts will limit our ability to extend credit to new customers and provide additional credit to current customers. The provisions related to complying with restrictions on over-limit fees and payment allocation will also significantly change our business as we have already advised our customers that we will no longer be charging over-limit fees and have made changes to our payment allocation practices. Several provisions of the CARD Act became effective in August 2009, but most of the requirements will become effective in February 2010 and others will become effective in August 2010. Legislation has been proposed to accelerate the effective date of all of the CARD Act provisions effective as soon as the legislation is enacted, but prospects for enactment are uncertain. Although the Federal Reserve has issued final rules implementing most of the provisions of the CARD Act, it has yet to issue rules implementing the provisions that take effect in August 2010. Accordingly, it is difficult to assess the impact of those provisions at this time.

The CARD Act s restrictions on finance charges and fees are expected to result in reduced interest income and loan fee income for us. We rely heavily on interest income. Our interest income from credit card loans was $2.8 billion for the 2009 fiscal year, which was 59% of revenues (defined as net interest income plus other income), excluding settlement payments received from Visa. Our loan fee income was $247.3 million for the 2009 fiscal year, which was 5% of revenues excluding the Visa payments. For the 2008 fiscal year, our interest income from credit card loans was $2.2 billion and our loan fee income was $262.6 million.

While we have already made, and anticipate making additional, changes to our pricing, credit and marketing practices that are designed to lessen the impact of the changes required by the CARD Act, there is no assurance that we will be successful. The long-term impact of the CARD Act on credit card industry profitability generally, and on our business practices and revenues, will depend upon consumer behavior and the actions of our competitors, which are difficult to predict at this time. Consumers may choose to use credit cards less frequently or for smaller dollar amounts. We may have to reconsider certain strategies in order to remain competitive. If we are not able to lessen the impact of the changes required by the CARD Act, the changes will have a material adverse effect on our results of operations.

As a participant in the U.S. Treasury s Capital Purchase Program, we are subject to restrictions and obligations, including limitations on our ability to pay dividends and repurchase our capital stock.

We issued and sold to the U.S. Department of the Treasury (the U.S. Treasury) senior preferred stock and a ten-year warrant to purchase our common stock for an aggregate purchase price of approximately $1.2 billion in March 2009. The issuance was part of the U.S. Treasury s Capital Purchase Program (CPP). Participation in the CPP subjects us to specific restrictions under the terms of the CPP, including limits on our ability to pay dividends (quarterly dividends on our common stock are limited to $0.06 per share or less) and repurchase our capital stock, limitations on executive compensation, and increased oversight by the U.S. Treasury, regulators and Congress under the Emergency Economic Stabilization Act of 2008, as amended (EESA). For details regarding these restrictions and other potential restrictions affecting the financial services industry generally, see Management s Discussion and Analysis of Financial Condition and Results of Operations Legislative and Regulatory Developments and Liquidity and Capital Resources U.S. Treasury Capital Purchase Program.

The relatively recent withdrawal of several of our banking competitors from the CPP may leave us at a competitive disadvantage as those institutions are no longer subject to the restrictions imposed under the CPP. Withdrawing from the CPP requires approval of banking regulators and we may not be able to obtain such approval, or a condition of obtaining such approval may require us to raise additional capital. Unanticipated consequences of participation in the CPP could materially and adversely affect our business, results of operations, financial condition, access to funding and the trading price of our common stock.

Our business, financial condition and results of operations could be adversely affected by new regulations and supervision to which we are subject as a result of becoming a bank holding company.

We became a bank holding company in March 2009. As a bank holding company, we are required to meet certain risk-based capital and leverage ratio requirements and submit financial and other reports to the Federal Reserve. Further, we are subject to organization-wide oversight and examination by the Federal Reserve, including scrutiny of our risk management program; business strategy, earnings, capital and cash flow; anti-money laundering program; and examination of our non-bank businesses, including Discover Network, PULSE and Diners Club, and their relationships with our banking subsidiaries. Finally, our business activities are restricted to those permitted by the Federal Reserve. If we fail to satisfy regulatory requirements applicable to bank holding companies or if the Federal Reserve uses its supervisory discretion to impose new or different limitations or requirements on our business, our financial condition and results of operations could be adversely affected.

Risks to Our Business

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

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

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

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

We incur considerable expenses in competing with other credit card issuers to attract and retain customers and increase card usage. A substantial portion of these expenses relates to marketing expenditures. We incurred expenses of $406.0 million and $530.9 million, in the 2009 and 2008 fiscal years, respectively, for marketing and business development. Because of the highly competitive nature of the credit card issuing business and increasing marketing challenges, a primary method of competition among credit card issuers, including us, has been to offer rewards programs, low introductory interest rates, attractive standard purchase rates and balance transfer programs that offer a favorable annual percentage rate or other financial incentives for a specified length of time on account balances transferred from another credit card. This type of competition has adversely affected credit card yields, and customers may frequently switch credit cards or transfer their balances to another card. There can be no assurance that any of the expenses we incur or incentives we offer to attempt to acquire and maintain accounts and increase card usage will be effective.

Furthermore, many of our competitors are larger than we are, have greater financial resources than we do and/or have lower capital, funding and operating costs than we have and expect to have, and have assets such as branch locations and co-brand relationships that may help them compete more effectively. In addition, there has been consolidation among credit card issuers, resulting in even greater pooled resources. We may be at a competitive disadvantage as a result of the greater scale of many of our competitors.

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

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

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Many of our competitors are well established, larger than we are and/or have greater financial resources than we do. These competitors have provided financial incentives to card issuers, such as large cash signing bonuses for new programs, funding for and sponsorship of marketing programs and other bonuses. Visa and MasterCard each have been in existence for more than 40 years and enjoy greater merchant acceptance and broader global brand recognition than we do. Although we have made progress in merchant acceptance, we have not achieved market parity with MasterCard and Visa. In addition, Visa and MasterCard have entered into long-term arrangements with many financial institutions that may have the effect of discouraging those institutions from issuing credit cards on the Discover Network or issuing debit cards on the PULSE Network. Some of these arrangements are exclusive, or nearly exclusive, which further limits our ability to conduct material amounts of business with these institutions.

Visa and MasterCard also may enact new rules or enforce other rules in the future, including rules that could have the effect of limiting the ability of issuing banks to use the PULSE Network, which may materially adversely affect our ability to compete. For example, MasterCard enacted a rule requiring banks that issue MasterCard signature debit cards to also participate in MasterCard s affiliated PIN debit network. MasterCard and Visa completed initial public offerings, which provided them with significant capital and may enhance their strategic flexibility. American Express is also a strong competitor, with international acceptance, high transaction fees and an upscale brand image. Internationally, American Express competes in the same market segments as Diners Club. We may face challenges in increasing international acceptance on our networks, particularly if third parties that we rely on to issue Diners Club cards, increase card acceptance, and market our brands do not perform to our expectations.

Furthermore, as a result of their dominant market position and considerable marketing and pricing power, Visa and MasterCard have been able to increase transaction fees charged to merchants in an effort to retain and grow their issuer volume. If we are unable to remain competitive on issuer interchange and other incentives, we may be unable to offer adequate pricing to third-party issuers while maintaining sufficient net revenues. At the same time, increasing the transaction fees charged to merchants or increasing acquirer interchange could adversely affect our effort to increase merchant acceptance of credit cards issued on the Discover Network and may cause merchant acceptance to decrease. This, in turn, could adversely affect our ability to attract third-party issuers and our ability to maintain or grow revenues from our proprietary network. Similarly, the PULSE Network operates in the highly competitive PIN debit business with well-established and financially strong network competitors (particularly Visa) that have the ability to offer significant incentives and bundled products to financial institutions.

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

In addition, the deterioration in the capital markets and costs of complying with recently enacted legislation has adversely affected some of our issuers, merchant acquirers and licensees, which are financial institutions. The failures of financial institutions and increased consolidation in the industry decrease our opportunities for new business and may result in the termination of existing business relationships if a business partner is acquired or goes out of business. In addition, financial institutions may have decreased interest in engaging in new card issuance opportunities or expanding existing card issuance relationships, which would inhibit our ability to grow our payment services business.

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

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

The success of our acquisition of Diners Club depends upon our ability to maintain the full operability of the Diners Club network for existing Diners Club cardholders, network licensees and merchants. We continue to rely on the assistance of Citigroup during a transition period for certain network and operational support services. If we were to lose the assistance of Citigroup, we may face difficulty maintaining operations at the same level. We rely upon numerous network partners for merchant acceptance for existing Diners Club customers. MasterCard s termination of cash access for Diners Club cardholders in the summer of 2009 limits the availability of cash access locations for Diners Club cardholders to ATMs available through our PULSE Network and certain over-the-counter cash access locations. Also, we have rerouted almost all merchant transactions for foreign Diners Club cards transacting in North America from the MasterCard acceptance network to the Discover Network, which we expect to complete in 2010. If we are unable to continue to offer either acceptable North American merchant acceptance or sufficient cash access locations to existing Diners Club customers, we may experience decreased transaction volume, which would reduce our revenues. The long-term success of our acquisition of Diners Club depends upon achieving card acceptance across our networks, which could include higher overall costs or longer timeframes than anticipated. If we are unable to successfully achieve card acceptance across our networks, we may be unable to achieve the synergies we anticipate and grow our business internationally.

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

Our risk management framework seeks to mitigate risk and appropriately balance risk and return. We have established processes and procedures intended to identify, measure, monitor and report the types of risk to which we are subject, including credit risk, market risk, liquidity risk, operational risk, legal and compliance risk, and strategic risk. We seek to monitor and control our risk exposure through a framework of policies, procedures and reporting requirements. However, there may be risks that exist, or that develop in the future, that we have not appropriately anticipated or identified. If our risk management framework does not effectively identify or mitigate our risks, we could suffer unexpected losses and could be materially adversely affected.

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

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

Our ability to manage credit risk and avoid high charge-off rates may be adversely affected by economic conditions that may be difficult to predict, particularly the continuing deterioration in the consumer credit environment. In anticipation of continued challenging economic conditions, we have increased our provision for loan losses as a result of higher charge-offs and in anticipation of higher future charge-off rates. The full-year owned net charge-off rate was 7.45% for 2009, up from 4.59% in 2008. At November 30, 2009 and 2008, $712 million, or 3.01%, and $617 million, or 2.45%, of our loan receivables were non-performing (defined as loans over 90 days delinquent and accruing interest plus loans not accruing interest). We expect the challenges in the consumer credit environment to continue, leading to increasing delinquency trends and higher charge-off rates. There can be no assurance that our underwriting and portfolio management strategies will permit us to avoid high charge-off levels, or that our provision for loan losses will be sufficient to cover actual losses.

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

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

We continue to add to our personal and student lending products and have expanded our marketing of these products. Our personal and student loan portfolios grew to $1.4 billion and $1.9 billion, respectively, at November 30, 2009, compared to $1.0 billion and $300 million, respectively, at November 30, 2008. We have less experience in these areas as compared to our traditional products and segments, and there can be no assurance that we will be able to grow these products in accordance with our strategies, manage our credit risk or generate sufficient revenue to cover our expenses in these markets. Our failure to manage our credit risks may materially adversely affect our profitability and our ability to grow these products, limiting our ability to further diversify our business.

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

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

Our liquidity reserve had a balance of approximately $14.2 billion as of November 30, 2009, compared to $9.4 billion as of November 30, 2008. We have increased our liquidity reserve in anticipation of approximately $12.5 billion of asset-backed securities and deposit maturities in the first half of 2010. Our total contingent liquidity sources as of November 30, 2009 amounted to $22.9 billion, consisting of $14.2 billion in our liquidity reserve, $4.8 billion Federal discount window capacity, $2.4 billion in a revolving credit facility, and $1.5 billion in asset-backed conduit capacity.

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

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

We obtain deposits from consumers either directly or through affinity relationships (direct-to-consumer deposits) and through third-party brokers who offer our deposits to their customers (brokered deposits). We have increased and plan to continue to increase our direct-to-consumer deposit funding. We had $12.6 billion in direct-to-consumer deposits and $19.5 billion in brokered deposits as of November 30, 2009, compared to $6.2 billion in direct-to-consumer deposits and $22.3 billion in brokered deposits as of November 30, 2008.

Many other financial services firms are increasing their use of deposit funding, including recently-formed bank holding companies, and as such we may experience increased competition in the deposit markets. We cannot predict how this

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increased competition will affect deposit renewal rates, costs or availability. If we are required to offer higher interest rates to attract or maintain deposits, our funding costs will be adversely impacted. In addition, our ability to maintain existing or obtain additional deposits may be impacted by factors beyond our control, including perceptions about our financial strength, which could lead to consumers choosing not to make deposits with us or third-party brokers not offering our deposit products.

Our ability to obtain deposit funding and offer competitive interest rates on deposits is also dependent on capital levels of our bank subsidiaries. The FDIA prohibits a bank, including our subsidiary Discover Bank, from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in its normal market area or nationally (depending upon where the deposits are solicited), unless (1) it is well-capitalized or (2) it is adequately capitalized and receives a waiver from the FDIC. A bank that is adequately capitalized may not pay an interest rate on any deposit, including direct-to-consumer deposits, in excess of 75 basis points over the national rate published by the FDIC. There are no such restrictions on a bank that is well-capitalized. While Discover Bank met the FDIC s definition of well-capitalized as of November 30, 2009, there can be no assurance that it will continue to meet this definition. For a comparison of Discover Bank s capital ratios to the well-capitalized capital requirements, see Note 21: Capital Adequacy to our consolidated financial statements. Additionally, our regulators can adjust the requirements to be well-capitalized at any time and have authority to place limitations on our deposit businesses, including the interest rate we pay on deposits. An inability to attract or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business.

If we do not securitize our receivables, it may have a material adverse effect on our liquidity, cost of funds and overall financial condition.

Historically, we have used the securitization of credit card receivables, which involves the transfer of receivables to a trust and the issuance by the trust of beneficial interests to third-party investors, as a significant source of funding. Our average level of securitized borrowings, excluding retained issuances, was $22.6 billion and $26.9 billion for the 2009 and 2008 fiscal years, respectively. Due to market events and disruption in the capital markets, the public and private securitization markets were not available to us from mid-2008 and into the first half of 2009. We re-entered the securitization markets in July and September 2009, with $1.5 billion and $1.3 billion, respectively, of public asset-backed securities issuances out of our securitization trusts that were eligible for funding under TALF. It is uncertain, however, whether the securitization markets will be available on terms or volumes that are attractive to us going forward, particularly after TALF expires in March 2010.

Further, while we have capacity to issue new asset-backed securities from our securitization trusts, there has been uncertainty in the securitization market recently over existing FDIC guidance regarding standards for legal isolation of the transferred assets following the change in accounting rules pertaining to transfers of financial assets and consolidations. This uncertainty has made it difficult to obtain necessary credit ratings for the issuances of asset-backed securities, including the required ratings for securities to qualify as eligible securities under TALF. Issuances after TALF expires on March 31, 2010 are subject to the final determination of the FDIC regarding the legal isolation standard, the potential framework of which was described in the FDIC s Advance Notice of Proposed Rulemaking in December 2009. The form that this rule will ultimately take is uncertain at this time, but it may impact our ability and/or desire to issue asset-backed securities in the future.

In addition, legislation approved in the U.S. House of Representatives in December 2009, and a similar measure under consideration in the U.S. Senate, propose extensive changes to the laws regulating financial services firms. These proposals include new requirements for the securitization market, including new rules around risk retention and disclosure. The form that this legislation may ultimately take is unknown at this time, but this legislation may impact our ability and desire to securitize our receivables.

The Securities and Exchange Commission (the SEC) is considering changes to the disclosure requirements for asset securitizations and changes to the requirements for shelf registration of asset securitizations. At this point, we cannot predict what specific changes will be proposed or adopted. However, significant changes to the disclosure requirements or registration process for our securitizations could make them more expensive or reduce our access to the capital markets, in either case making securitization less viable as a funding source.

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

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

Our liquidity would be materially adversely affected by the occurrence of events that could result in the early amortization of our existing securitization transactions. Credit card securitizations are normally structured as revolving transactions that do not distribute to securitization investors their share of monthly principal payments on the receivables during the revolving period, and instead use those principal payments to fund the purchase of replacement receivables. The occurrence of early amortization events may result in termination of the revolving periods of our securitization transactions, which would require us to repay the affected outstanding securitized borrowings over a period of a few months. Our average level of securitized borrowings, excluding retained issuances, was $22.6 billion and $26.9 billion for the 2009 and 2008 fiscal years, respectively, and we recorded $1.9 billion and $2.4 billion, respectively, in securitization income. Early amortization events include, for example, insufficient cash flows in the securitized pool of receivables to meet contractual requirements (also known as excess spread), certain breaches of representations, warranties or covenants in the agreements relating to the securitization and receivership or insolvency of Discover Bank. For more information on excess spread, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Securitization Financing. An early amortization event would negatively impact our liquidity, and require us to rely on alternative funding sources, which may or may not be available at the time.

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

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

We, along with Discover Bank, are regularly evaluated by the ratings agencies, and their ratings for our long-term debt and other securities, including asset-backed securities issued by our securitization trusts, are based on a number of factors, including our financial strength as well as factors that may not be within our control. We currently maintain an investment grade long-term debt rating with Fitch Ratings (Fitch) (BBB with negative outlook) and Standard and Poor s Rating Service (S&P) (BBB- with stable outlook). In 2009, Moody s Investors Service (Moody s) downgraded our long-term debt rating from Baa3 with negative outlook to Ba1 with negative outlook. Our current Ba1 rating from Moody s is below investment grade. Downgrades in our long-term debt ratings could materially adversely affect our cost of funds, access to capital and funding, and overall financial condition. There can be no assurance that we will be able to maintain our current credit ratings or that our credit ratings will not be lowered or withdrawn in its entirety.

Discover Bank currently maintains an investment grade long-term debt rating with Fitch (BBB with negative outlook) and S&P (BBB with stable outlook). Moody s downgraded the long-term debt rating of Discover Bank in 2009 from Baa2 with negative outlook to Baa3 with negative outlook, which remains at investment grade level. Failure to maintain an investment grade long-term debt rating could materially adversely affect the cost of funds, access to capital and funding, and overall financial condition of Discover Bank. There can be no assurance that Discover Bank will be able to maintain its current credit ratings or that its credit ratings will not be lowered or withdrawn in their entirety.

The credit ratings of the securities issued by our securitization trusts are regularly evaluated by the rating agencies. The ratings of our asset-backed securities are based on a number of factors, including the quality of the underlying receivables and the credit enhancement structure of the trusts. One rating agency has indicated that it will adjust its methodology to give greater consideration to the effect the financial strength of Discover Bank, as originator of the credit card receivables and master servicer of the securitization trusts, may have on the performance of the underlying credit card asset-backed securities when determining the credit rating of the trust securities, which could negatively impact the ratings of our asset-backed securities. The rating agencies may require us to take certain credit enhancement actions to maintain the ratings of the securities issued out of our trusts, which we may not be able to complete. TALF currently requires a triple-A or equivalent rating from at least two nationally recognized rating agencies for an issuance to qualify as eligible collateral. Failure to maintain the credit ratings of our asset-backed securities could prevent us from issuing new securities from our securitization trusts that are eligible securities under TALF or otherwise, which may have a material adverse effect on our liquidity, cost of funds and overall financial condition.

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

We must effectively manage the risks of the investments in our liquidity reserve. Investments in our liquidity reserve may be adversely affected by market fluctuations including changes in interest rates, prices, credit risk premiums and overall market liquidity. Also, investments backed by collateral could be adversely impacted by changes in the value of the underlying collateral. Certain markets have been experiencing disruptions in market liquidity, and the lack of a secondary market may adversely affect the valuation of certain of our investments. In addition, deteriorating economic conditions may cause certain of the obligors, counterparties and underlying collateral on our investments to incur losses of their own, thereby increasing our credit risk exposure to these investments. These risks could result in a decrease in the value of our investments, which could negatively impact our financial condition. For example, for the years ended November 30, 2009 and 2008, we recorded losses of $8.2 million and $49.1 million, respectively, on an investment in certain asset-backed commercial paper notes purchased in a prior period.

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

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

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

We have a credit facility that could restrict our operations.

We have a multi-year unsecured committed credit facility that currently has $2.4 billion available and contains restrictions, covenants and events of default. See Management s Discussion and Analysis of Financial Condition and

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Results of Operations Liquidity and Capital Resources Additional Funding Sources. Although we currently have no outstanding balances due under the facility, the terms of the facility impose certain restrictions and future indebtedness may impose various additional restrictions and covenants on us (such as tangible net worth requirements) that could have adverse consequences, including: limiting our ability to pay dividends to our stockholders; increasing our vulnerability to changing economic, regulatory and industry conditions; limiting our ability to compete and our flexibility in planning for, or reacting to, changes in our business and the industry; limiting our ability to borrow additional funds; and requiring us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing funds available for working capital, capital expenditures, acquisitions and other purposes.

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

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

We may be unable to grow earnings if we fail to attract new customers, or if we attract customers lacking favorable spending and payment habits.

We seek to attract new customers who will use their Discover cards, meet their monthly payment obligations and maintain balances that generate interest and fee income for us. We are subject to substantial competition from other credit card issuers for these new customers. We may not have adequate financial resources to permit us to incur all of the marketing costs that may be necessary to maintain or grow our receivables or to attract new accounts. The spending and payment habits of these new customers may not be sufficient to make their accounts as profitable as we expect. In addition, our risk models may not accurately predict the credit risk for these new customers, which could result in unanticipated losses in future periods. To the extent that the spending and payment habits of new customers do not meet our expectations, our earnings and growth may be negatively affected.

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

Discover card transaction volume was concentrated among our top 100 merchants in 2009, with our largest merchant accounting for nearly 10% of that transaction volume. These merchants may pressure us to reduce our rates by continuing to participate in the Discover Network only on the condition that we change the terms of their economic participation. Loss of acceptance at our largest merchants would decrease transaction volume, negatively impact our brand, and could cause customer attrition. At the same time, we are subject to increasing pricing pressure from third-party issuers as a result of the continued consolidation in the banking industry, which results in fewer large issuers that, in turn, generally have a greater ability to negotiate higher interchange fees. In addition, some of our merchants, primarily our small and mid-size merchants, are not contractually committed to us for any period of time and may cease to participate in the Discover Network at any time on short notice.

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

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

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

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

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

If we are unable to maintain successful relationships with the network licensees that issue Diners Club cards and that maintain a merchant acceptance network, we may be unable to sustain and grow our international network business.

The success of Diners Club depends upon the cooperation and support of the network licensees that issue Diners Club cards and that maintain a merchant acceptance network including Citigroup, which currently owns and operates network licensees generating over 40% of the Diners Club network sales volume. As is the case for other card payment networks, Diners Club does not issue cards or determine the terms and conditions of cards issued by the network licensees. Each licensee issuer determines these.

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

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

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

Visa and MasterCard may impose additional restrictions on issuing banks, merchants or merchant acquirers that materially adversely affect our networks, or the Discover card issuing business.

Visa and MasterCard aggressively seek to protect their networks from competition and have used their rules and policies to do so. For example, in the past they enacted and enforced rules that prohibited their member banks from issuing cards on competing payment networks such as Discover. These rules were ultimately found to violate the antitrust laws. They have adversely affected our business in the past, and they may have lingering effects going forward. Visa and MasterCard also may enact new rules or enforce other rules in the future, including limiting the ability of issuing banks to use the PULSE Network, which may materially adversely affect our ability to compete. For example, MasterCard has issued a mandate requiring its signature debit issuing banks to also utilize MasterCard s affiliated PIN debit network.

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

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

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

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

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

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

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

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

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

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

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

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

As an issuer and merchant acquirer in the United States on the Discover Network, and as a holder of certain merchant agreements internationally for the Diners Club network, we may be contingently liable for certain disputed credit card sales transactions that arise between customers and merchants. If a dispute is resolved in the customer s favor, we will cause a credit or refund of the amount to be issued to the customer and charge back the transaction to the merchant or merchant acquirer. If we are unable to collect this amount from the merchant or merchant acquirer, we will bear the loss for the amount credited or refunded to the customer. Where the purchased product or service is not provided until some later date following the purchase, such as an airline ticket, the likelihood of potential liability increases. For the years ended November 30, 2009 and 2008, we had $5.8 million and $10.5 million, respectively, of losses related to merchant chargebacks.

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

Our success depends, in large part, on our ability to retain, recruit and motivate key officers and employees to manage our business. Our senior management team has significant industry experience and would be difficult to replace. Our senior management team is relatively small and we believe we are in a critical period of competition in the financial services and payments industry. The market for qualified individuals is highly competitive, and we may not be able to attract and retain qualified personnel or candidates to replace or succeed members of our senior management team or other key personnel.

As a participant in the U.S. Treasury Capital Purchase Program, we are subject to significant restrictions on how we may compensate our top five senior executive officers (SEOs) and our next 20 most highly compensated employees under the Interim Final Rule issued by the U.S. Treasury pursuant to the EESA. The EESA generally limits the amount of bonus or incentive compensation payable to our SEOs and our next 20 most highly compensated employees to one-third of the total amount of their annual compensation and limits the form of such payments to long-term restricted stock that does not fully vest during the period in which the senior preferred stock is held by the U.S. Treasury. In addition, the EESA could require the clawback of previously paid compensation to these employees. The EESA also restricts severance payments for our SEOs and our next five most highly compensated employees except for payments for services performed or benefits accrued. Several of the companies with which we compete for senior talent did not participate in, or are no longer participants in, the Capital Purchase Program and, therefore, are not subject to such compensation limitations.

We may be subject to further restrictions under any other future legislation or regulation limiting executive compensation. For example, in October 2009, the Federal Reserve issued proposed guidance on incentive compensation policies at banking organizations. These restrictions could negatively impact our ability to compete with other companies in recruiting and retaining key officers and employees. If we are unable to recruit, retain and motivate key personnel, our business could be materially adversely affected.

Damage to our reputation could damage our businesses.

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

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

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

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

Acquisitions or strategic investments that we pursue could disrupt our business and harm our financial condition.

We may consider or undertake strategic acquisitions of, or material investments in, businesses, products or technologies. If we do so, we may not be able to successfully finance or integrate any such businesses, products or technologies. In addition, the integration of any acquisition may divert management s time and resources from our core business and disrupt our operations. We may allocate resources, such as time and money, on projects that do not increase our earnings. To the extent we pay the purchase price of any acquisition in cash, it would reduce our cash balances; similarly, if the purchase price is paid with our stock, it could be dilutive to our stockholders.

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

We must comply with an array of banking and consumer lending laws and regulations in all of the jurisdictions in which we operate. As a bank holding company, we are subject to oversight, regulation and examination by the Federal Reserve. Our subsidiary, Discover Bank, is subject to regulation and regular examinations by the FDIC and the Delaware Bank Commissioner. In addition, we are subject to regulation by the Federal Trade Commission, state banking regulators and the U.S. Department of Justice, as well as the SEC and New York Stock Exchange in our capacity as a public company. In addition, as our payments business has expanded globally through the acquisition of Diners Club, we are subject to government regulation in countries in which our networks operate or our cards are used, either directly or indirectly through regulation affecting Diners Club network licensees.

From time to time, these regulations and regulatory agencies have required us to alter certain of our operating practices, and may require us to do the same in the future. Our ability to introduce new products or introduce new pricing may be impaired or delayed as a result of regulatory review or failure to obtain required regulatory approvals. Various federal and state regulators have broad discretion to impose restrictions and requirements on our company, subsidiaries and operations. U.S. federal and state consumer protection laws and rules, and laws and rules of foreign jurisdictions where we conduct business limit the manner and terms on which we may offer and extend credit. We are subject to capital, funding and liquidity requirements prescribed by statutes, regulations and orders. We are also subject to the requirements of accounting standard setters and those who interpret the accounting standards (such as the FASB, the SEC, banking regulators and our outside auditors), who may change their interpretations on how standards should be applied, potentially materially impacting how we record and report our financial condition and results of operations. Failure to comply with laws, regulations and other requirements could lead to adverse consequences such as financial, structural, reputational and operational penalties, including receivership, litigation exposure and fines. In addition, efforts to abide by these laws and regulations may increase our costs of operations or limit our ability to engage in certain business activities, including affecting our ability to generate or collect receivables from customers.

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

Proposals for legislation further regulating matters affecting public companies are continually being introduced in the U.S. Congress and in state legislatures, including reforms related to health care, employment and particularly the financial services industry. Congress is considering extensive changes to the laws regulating financial services firms, including bills that address risks to the economy and the payments system through a variety of measures. Legislation approved in the House in December 2009, and a similar measure under consideration in the Senate, propose a new independent Consumer Financial Protection Agency (CFPA) that would regulate consumer financial services and products, including credit, savings and payment products. The President has made the enactment of financial reform legislation a priority, although there is significant opposition to several components, including the creation of a CFPA. Passage of the bills in their present form would have a material adverse impact on us, but prospects for approval of the legislation, and the content of a final bill, are unclear.

The agencies regulating the financial services industry also periodically adopt changes to their regulations and supervisory guidance and practices. In light of current conditions in the U.S. financial markets and economy, as well as a heightened regulatory and Congressional focus on consumer lending, regulators have increased their scrutiny of the financial services industry, the result of which has included new proposed regulations and regulatory guidance. For example, in October 2009, the Federal Reserve issued proposed guidance on incentive compensation policies at banking organizations. We are unable to predict the impact of this enhanced scrutiny or whether any of these proposals will be implemented or in what form. We are also unable to predict whether any additional or similar changes to statutes or regulations, including the interpretation or implementation thereof, will occur in the future.

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

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

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

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

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

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

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

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Risks Related to Our Spin-Off

Certain of our historical financial results are as a business segment of Morgan Stanley and therefore may not be representative of our results as a separate, stand-alone company.

Certain historical financial information we have included in this filing has been derived from Morgan Stanley s consolidated financial statements and does not necessarily reflect what our financial condition, results of operations or cash flows would have been had we operated as a separate, stand-alone company during the periods presented. For example, our funding costs increased after our separation from Morgan Stanley. In addition, certain historical costs and expenses reflected in our audited consolidated financial statements include an allocation for certain corporate functions historically provided by Morgan Stanley, including general corporate expenses, employee benefits and incentives. These allocations were based on what we and Morgan Stanley considered to be reasonable reflections of the historical utilization levels of these services required in support of our business. This historical information does not necessarily indicate what our results of operations, financial condition, cash flows or costs and expenses would have been had we operated as a separate, stand-alone entity, nor is it indicative of what our results will be in the future.

Special Note Regarding Forward-Looking Statements

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

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

- changes in economic variables, such as the availability of consumer credit, the housing market, energy costs, the number and size of personal bankruptcy filings, the rate of unemployment and the levels of consumer confidence and consumer debt, and investor sentiment;

- the impact of current, pending and future legislation, regulation and regulatory and legal actions, including new laws and rules limiting or modifying certain credit card practices, new laws and rules affecting securitizations, new laws and rules related to government programs to stabilize the financial markets and regulations related to becoming a bank holding company;

- the restrictions on our operations resulting from financing transactions including participation in the U.S. Treasury s Capital Purchase Program;

- the actions and initiatives of current and potential competitors;

- our ability to successfully achieve card acceptance across our networks and maintain relationships with network participants;

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

- the availability and cost of funding and capital;

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

the impact of rating agency actions;

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

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- losses in our investment portfolio;
- our ability to increase or sustain Discover card usage or attract new customers;
- our ability to attract new merchants and maintain relationships with current merchants;
- the effect of political, economic and market conditions, geopolitical events and unforeseen or catastrophic events;
- fraudulent activities or material security breaches of key systems;
- our ability to introduce new products or services;
- our ability to sustain our investment in new technology and manage our relationships with third-party vendors;
- our ability to collect amounts for disputed transactions from merchants and merchant acquirers;
- our ability to attract and retain employees;
- our ability to protect our reputation and our intellectual property;
- difficulty financing or integrating new businesses, products or technologies;
- new lawsuits, investigations or similar matters or unanticipated developments related to current matters; and
- resolution of our dispute with Morgan Stanley.

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal properties are located in seven states in the United States. As of January 15, 2010, we owned five principal properties, which included our corporate headquarters, two call centers and two processing centers (one of which we intend to close in 2010) and we leased three principal properties, which included two call centers and our PULSE headquarters. The call centers and processing centers largely support our Direct Banking segment, formerly referred to as our U.S. Card segment, the PULSE headquarters is used by our Payment Services segment, formerly referred to as our Third-Party Payments segment, and our corporate headquarters is used by both our Direct Banking and Payment Services segments. We also have five leased offices, four of which are located outside the United States, that are used to support our Diners Club operations and a leased office in Shanghai that supports our Direct Banking segment. Excluding the one processing center to be closed later in 2010, all of our call centers and processing centers are operating at and being utilized to a reasonable capacity and we believe these principal facilities are both suitable and adequate to meet our current and projected needs.

Item 3. Legal Proceedings

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

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

We filed a lawsuit captioned Discover Financial Services, Inc. v. Visa USA Inc., MasterCard Inc. et al. in the U.S. District Court for the Southern District of New York on October 4, 2004. Through this lawsuit we sought to recover substantial damages and other appropriate relief in connection with Visa s and MasterCard s illegal anticompetitive practices that, among other things, foreclosed us from the credit and debit network services markets. The lawsuit followed the U.S. Supreme Court s October 2004 denial of Visa s and MasterCard s petition for review of the decision of the U.S. Court of Appeals affirming a lower court decision in a case brought by the U.S. Department of Justice in which the court found that Visa s and MasterCard s exclusionary rules violated the antitrust laws and harmed competition and consumers by foreclosing us from offering credit and debit network services to banks.

We executed an agreement to settle the lawsuit with MasterCard and Visa on October 27, 2008. The agreement became effective on November 4, 2008 upon receipt of the approval of Visa s Class B shareholders. Under the settlement, Visa and MasterCard agreed to pay us up to $2.75 billion in exchange for our agreement to dismiss the lawsuit and release all claims. MasterCard paid us $862.5 million in the fourth quarter of 2008. We met all financial performance measures to which we were subject under the settlement agreement and, as a result, we received the maximum amount of $1.9 billion, plus interest, in four quarterly payments from Visa in fiscal 2009.

At the time of our 2007 spin-off from Morgan Stanley, we entered into an agreement with Morgan Stanley regarding the manner in which the antitrust case against Visa and MasterCard was to be pursued and settled and how proceeds of the litigation were to be shared (the Special Dividend Agreement). As previously disclosed, the agreement provided that, upon resolution of the litigation, after expenses, we would be required to pay Morgan Stanley the first $700 million of value of cash or non-cash proceeds (increased at the rate of 6% per annum until paid in full), plus 50% of any proceeds in excess of $1.5 billion, subject to certain limitations and a maximum potential payment to Morgan Stanley of $1.5 billion. All payments by us to Morgan Stanley would be net of taxes payable by us with respect to such proceeds. In addition, the agreement provides that any amounts payable to Morgan Stanley that are not paid within thirty days following the end of a fiscal quarter in which proceeds are received by us will accrue interest from the thirtieth day until paid at a rate of 6% per annum.

On October 21, 2008, Morgan Stanley filed a lawsuit against us in New York Supreme Court for New York County seeking a declaration that Morgan Stanley did not breach the Special Dividend Agreement, did not interfere with any of our existing or prospective agreements for resolution of the antitrust case against Visa and MasterCard, and that Morgan Stanley is entitled to receive a portion of the settlement proceeds as set forth in the Special Dividend Agreement. On November 18, 2008, we filed our response to Morgan Stanley s lawsuit, which includes counterclaims against Morgan Stanley for interference with our efforts to resolve the antitrust lawsuit against Visa and MasterCard and willful and material breach of the Special Dividend Agreement, which expressly provided that we would have sole control over the investigation, prosecution and resolution of the antitrust lawsuit. Through our counterclaims we seek a ruling that because of Morgan Stanley s willful, material breach of the Special Dividend Agreement, it has no right to its share of the proceeds from the settlement. We have also requested damages in an amount to be proven at trial. Morgan Stanley moved for partial summary judgment seeking payment of its share of the proceeds, and on January 4, 2010, the court issued an order granting the motion. We intend to appeal the order and to continue to pursue our separate claims for damages. The parties substantially completed the fact discovery phase of the case in December 2009. Expert reports are due in January and February 2010, and dispositive motions are to be filed in March 2010. See Note 28: Subsequent Events to our consolidated financial statements for additional information.

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Other Matters

On October 10, 2008, 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 Section 1 of the Sherman Act, 15 U.S.C. § 1. The CID seeks documents, data and narrative responses to several interrogatories and document requests, which focus on certain payment card network rules relating to merchant acceptance practices, including those that apply to merchants ability to steer customers to payment forms preferred by merchants. 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. We are cooperating with the Division in connection with the CID.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of our year ending November 30, 2009, no matters were submitted for a vote of our stockholders.

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

Common Stock Market Prices and Dividends

Our common stock began trading regular way on the NYSE (ticker symbol DFS) on July 2, 2007. The approximate number of record holders of our common stock at January 15, 2010 was 91,422.

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

Quarter Ended:	**Stock Price**		**Cash Dividends**
2007	**High**	**Low**	**Declared**
August 31	$ 29.15	$ 20.35	
November 30	$ 24.00	$ 15.72	$ 0.06
2008			
February 29	$ 17.99	$ 10.94	$ 0.06
May 31	$ 19.87	$ 13.00	$ 0.06
August 31	$ 17.16	$ 12.51	$ 0.06
November 30	$ 18.15	$ 6.59	$ 0.06
2009			
February 28	$ 11.47	$ 5.05	$ 0.06
May 31	$ 11.65	$ 4.73	$ 0.02
August 31	$ 14.24	$ 8.58	$ 0.02
November 30	$ 17.36	$ 12.87	$ 0.02

During our second quarter of 2009, we reduced our common stock dividend from $.06 per share to $.02 per share and we have maintained a $.02 per share dividend for the remaining quarters of 2009. We expect to continue our policy of paying regular cash dividends, although there is no assurance as to future dividends because they are subject to board approval and depend on future earnings, capital requirements and financial condition. Our participation in the U.S. Treasury s Capital Purchase Program subjects us to restrictions limiting our ability to pay dividends on our common stock. For a description of these restrictions, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources U.S. Treasury Capital Purchase Program. In addition, as a result of applicable banking regulations and provisions that may be contained in our borrowing agreements or the borrowing agreements of our subsidiaries, our ability to pay dividends to our stockholders may be further limited.

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Issuer Purchases of Equity Securities

The table below sets forth the information with respect to purchases of our common stock made by us or on our behalf during the fourth quarter of our year ended November 30, 2009:

Period	Total Number of Shares Purchased[(2)]	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[(1)]	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
September 1 30, 2009				
Repurchase program[(1)]		$		$ 1 billion
Employee transactions[(2)]	16,146	$ 11.37	N/A	N/A
October 1 31, 2009				
Repurchase program[(1)]		$		$ 1billion
Employee transactions[(2)]		$	N/A	N/A
November 1 30, 2009				
Repurchase program[(1)]		$		$ 1billion
Employee transactions[(2)]	54,357	$ 15.69	N/A	N/A
Total				
Repurchase program[(1)]		$		$ 1billion
Employee transactions[(2)]	70,503	$ 14.70	N/A	N/A

(1) On December 3, 2007, we announced that our board of directors authorized the repurchase of up to $1 billion of our outstanding stock under a new share repurchase program. This share repurchase program expires on November 30, 2010, and may be terminated at any time. At November 30, 2009, we had not repurchased any stock under this program. Under the terms of our participation in the U.S. Treasury s Capital Purchase Program, we are generally prohibited from repurchasing our common stock until March 2012, as more fully described in Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Stock Repurchase Program.

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

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Stock Performance Graph

The following graph compares the cumulative total stockholder return (rounded to the nearest whole dollar) of our common stock, the S&P 500 Stock Index and the S&P 500 Financials Index for the period from July 2, 2007 through November 30, 2009. The graph assumes an initial investment of $100 on July 2, 2007, the date we began regular way trading on the NYSE following our spin-off. The cumulative returns include stock price appreciation and assume full reinvestment of dividends. This graph does not forecast future performance of our common stock.

	Discover Financial Services	S&P 500 Index	S&P 500 Financials Index
July 2, 2007	$ 100.00	$ 100.00	$ 100.00
November 30, 2007	$ 63.14	$ 97.48	$ 84.67
May 31, 2008	$ 62.40	$ 92.16	$ 67.82
November 30, 2008	$ 36.89	$ 58.99	$ 34.60
May 31, 2009	$ 34.47	$ 60.49	$ 33.48
November 30, 2009	$ 56.63	$ 72.11	$ 40.11

Item 6. Selected Financial Data

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

The selected financial data as of and for the years ended November 30, 2006 and 2005, are for periods prior to our spin-off from Morgan Stanley, are unaudited and are presented on a combined basis. The unaudited financial statements have been prepared on the same basis as the audited financial statements, and in the opinion of our management include all adjustments, consisting of only ordinary recurring adjustments, necessary for a fair presentation of the information set forth in this annual report on Form 10-K.

The selected financial data presented on a combined basis reflects the historical combined income and financial condition of the Morgan Stanley subsidiaries that comprised its Discover segment. Prior to our spin-off, the Discover segment consisted of Discover Financial Services, a wholly-owned subsidiary of Morgan Stanley, and certain other subsidiaries and assets related to credit card operations in the United Kingdom, which are now presented as discontinued operations, that were contributed to the Discover segment by Morgan Stanley in conjunction with the spin-off. The

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combined selected financial data presented for 2006 and 2005 do not reflect any changes that have occurred in our financing and operations as a result of our spin-off and accordingly, may not be indicative of our future performance or of the results that would have been achieved had we operated as a separate, stand-alone entity during those periods. However, the combined financial data presented for 2006 and 2005 have been prepared on the same basis as the audited financial statements, and in the opinion of our management, include all adjustments, consisting of only ordinary recurring adjustments, necessary for a fair presentation of the information set forth in this annual report on Form 10-K.

Included in the selected historical financial data are certain amounts and statistics reported on a managed basis. Our senior management evaluates business performance and allocates resources using financial data that is presented on a managed basis. Managed loans consist of our on-balance sheet loan portfolio, loans held for sale and loan receivables that have been securitized and against which beneficial interests have been issued. Owned loans, a subset of managed loans, refer to our on-balance sheet loan portfolio and loans held for sale and include the undivided seller s interest we retain in our securitizations. A managed basis presentation, which is not a presentation in accordance with GAAP, involves reporting securitized loans with our owned loans in the managed basis statements of financial condition and reporting the earnings on securitized loans in the same manner as the owned loans instead of as securitization income. See Management s Discussion and Analysis of Financial Condition and Results of Operations GAAP to Managed Data Reconciliations.

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Discover Financial Services

Selected Historical Data

	For the Years Ended November 30,				
	2009	2008	2007	2006	2005
	(dollars in thousands, except per share amounts)				
Statement of Income Data:					
Interest income	$ 3,145,080	$ 2,692,563	$ 2,584,402	$ 2,209,192	$ 2,035,263
Interest expense	1,251,284	1,288,004	1,223,270	836,280	718,213
Net interest income	1,893,796	1,404,559	1,361,132	1,372,912	1,317,050
Other income(1)	4,840,595	4,264,458	3,376,682	3,368,664	2,820,128
Revenue net of interest expense	6,734,391	5,669,017	4,737,814	4,741,576	4,137,178
Provision for loan losses	2,362,405	1,595,615	733,887	606,765	816,197
Other expense	2,251,088	2,415,797	2,478,214	2,467,058	2,364,991
Income before income tax expense	2,120,898	1,657,605	1,525,713	1,667,753	955,990
Income tax expense	844,713	594,692	561,514	535,563	356,434
Income from continuing operations	1,276,185	1,062,913	964,199	1,132,190	599,556
Loss from discontinued operations, net of tax(2)		(135,163)	(375,569)	(55,574)	(21,641)
Net income(1)	$ 1,276,185	$ 927,750	$ 588,630	$ 1,076,616	$ 577,915
Net income available to common stockholders	$ 1,222,930	$ 927,750	$ 588,630	$ 1,076,616	$ 577,915
Statement of Financial Condition Data (as of):					
Loan receivables	$ 23,625,084	$ 25,216,611	$ 20,831,117	$ 20,790,244	$ 20,611,306
Total assets	$ 46,020,987	$ 39,892,382	$ 37,376,105	$ 29,064,898	$ 26,942,109
Total stockholders equity	$ 8,435,547	$ 5,915,823	$ 5,599,422	$ 5,774,772	$ 4,600,449
Allowance for loan losses	$ 1,757,899	$ 1,374,585	$ 759,925	$ 703,917	$ 795,722
Long-term borrowings	$ 2,428,101	$ 1,735,383	$ 2,134,093	$ 819,496	$ 820,529
Total average interest-earning assets	$ 39,989,758	$ 33,409,965	$ 28,267,731	$ 22,880,808	$ 22,245,351
Total average interest-bearing liabilities	$ 31,609,777	$ 27,644,581	$ 23,211,976	$ 17,449,405	$ 17,378,284
Per Share of Common Stock:					
Basic EPS from continuing operations	$ 2.42	$ 2.22	$ 2.02	$ 2.37	$ 1.26
Diluted EPS from continuing operations	$ 2.39	$ 2.20	$ 2.01	$ 2.37	$ 1.26
Weighted average shares outstanding (000 s)(3)	504,550	479,335	477,328	477,236	477,236
Weighted average shares outstanding (fully diluted) (000 s)(3)	511,803	483,470	478,879	477,236	477,236
Cash dividends declared	$ 0.12	$ 0.24	$ 0.06		
Dividend payout ratio	4.96%	12.40%	4.88%		
Ratios:					
Net interest margin	4.74%	4.20%	4.82%	6.00%	5.92%
Return on average equity	17%	16%	10%	20%	13%
Return on average assets	3.02%	2.52%	1.74%	3.93%	2.29%
Average stockholders equity to average total assets	18%	15%	17%	20%	17%

(1) The years ended November 30, 2009 and 2008 include $1.9 billion pretax ($1.2 billion after tax) and $0.9 billion pretax ($0.5 billion after tax), respectively, of income related to the Visa and MasterCard antitrust litigation settlement, which is included in our Direct Banking segment, formerly referred to as our U.S. Card segment. See Legal Proceedings.

(2) 2007 includes a $391 million pretax ($279 million after tax) non-cash impairment charge to write-down the intangible assets and goodwill of the Goldfish business, which was sold on March 31, 2008.

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

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	For the Years Ended November 30,				
	2009	2008	2007	2006	2005
	(dollars in thousands)				
Selected Statistics:					
Total Loan Receivables					
Loan receivables owned	$ 23,625,084	$ 25,216,611	$ 20,831,117	$ 20,790,244	$ 20,611,306
Average loan receivables owned	$ 26,552,574	$ 21,348,493	$ 19,947,784	$ 19,252,929	$ 18,875,378
Owned interest yield	11.31%	10.89%	10.73%	10.48%	10.12%
Owned net principal charge-off rate	7.45%	4.59%	3.40%	3.63%	4.93%
Owned delinquency rate (over 30 days)	4.92%	4.35%	3.26%	3.05%	3.67%
Owned delinquency rate (over 90 days)	2.58%	2.06%	1.51%	1.43%	1.60%
Loan receivables managed	$ 50,860,372	$ 51,095,278	$ 48,180,436	$ 45,802,071	$ 44,437,450
Average loan receivables managed	$ 51,140,614	$ 49,011,148	$ 46,913,474	$ 44,409,232	$ 44,967,420
Managed interest yield	12.36%	12.61%	12.65%	12.52%	11.75%
Managed net principal charge-off rate	7.77%	5.01%	3.83%	3.95%	5.29%
Managed delinquency rate (over 30 days)	5.31%	4.56%	3.58%	3.39%	3.97%
Managed delinquency rate (over 90 days)	2.78%	2.17%	1.67%	1.59%	1.74%
Total Credit Card Loan Receivables					
Credit card loan receivables owned	$ 20,230,302	$ 23,814,307	$ 20,579,923	$ 20,694,395	$ 20,434,977
Average credit card loan receivables owned	$ 24,266,782	$ 20,566,864	$ 19,845,880	$ 19,120,946	$ 18,644,660
Owned interest yield	11.69%	10.92%	10.75%	10.50%	10.16%
Owned net principal charge-off rate	7.87%	4.73%	3.41%	3.64%	4.95%
Owned delinquency rate (over 30 days)	5.52%	4.55%	3.28%	3.05%	3.69%
Owned delinquency rate (over 90 days)	2.92%	2.16%	1.53%	1.44%	1.61%
Credit card loan receivables managed	$ 47,465,590	$ 49,692,974	$ 47,929,242	$ 45,706,222	$ 44,261,121
Average credit card loan receivables managed	$ 48,854,822	$ 48,229,519	$ 46,811,570	$ 44,277,249	$ 44,736,702
Managed interest yield	12.59%	12.65%	12.66%	12.53%	11.78%
Managed net principal charge-off rate	8.00%	5.07%	3.84%	3.96%	5.30%
Managed delinquency rate (over 30 days)	5.60%	4.66%	3.59%	3.39%	3.98%
Managed delinquency rate (over 90 days)	2.94%	2.22%	1.68%	1.59%	1.75%

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

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

Unless otherwise specified, references to Notes to our consolidated financial statements are to the Notes to our audited consolidated financial statements as of November 30, 2009 and 2008 and for the three-year period ended November 30, 2009.

Introduction and Overview

Discover Financial Services is a leading credit card issuer in the United States and an electronic payment services company. In March 2009, we became a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act in connection with our participation in the U.S. Treasury s Capital Purchase Program (CPP). Therefore, we are now subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve). Through our Discover Bank subsidiary, we offer our customers credit cards, other consumer loans and deposit products. Through our DFS Services LLC subsidiary and its subsidiaries, we operate the Discover Network, the PULSE Network and Diners Club. The Discover Network operates a credit card transaction processing network for Discover card-branded and third-party issued credit cards. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE Network with access to ATMs domestically and internationally, as well as point of sale terminals at retail locations throughout the U.S. for debit card transactions. Diners Club is a global payments network that grants rights to licensees, which are generally financial institutions, to issue Diners Club branded credit cards and/or to provide card acceptance services. Our Diners Club business also offers transaction processing and marketing services to licensees globally. Our fiscal year ends on November 30 of each year.

Our primary revenues come from interest income earned on loan receivables, securitization income derived from the transfer of credit card loan receivables to securitization trusts and subsequent issuance of beneficial interests through securitization transactions, and fees earned from customers, merchants and issuers. The primary expenses required to operate our business include funding costs (interest expense), loan loss provisions, customer rewards, and expenses incurred to grow, manage and service our loan receivables.

Our business activities are funded primarily through the raising of consumer deposits, securitization of loan receivables and the issuance of both secured and unsecured debt. In a credit card securitization, loan receivables are transferred to a securitization trust, from which beneficial interests are issued to investors. We continue to own and service the accounts that generate the securitized loans. The trusts utilized by us to facilitate asset securitization transactions are not our subsidiaries. These trusts are excluded from our consolidated financial statements in accordance with accounting principles generally accepted in the United States (GAAP). Because our securitization activities qualify as sales under GAAP and accordingly are not treated as secured financing transactions, we remove credit card loan receivables equal to the amount of the investors interests in securitized loans from our consolidated statements of financial condition. As a result, asset securitizations have a significant effect on our consolidated financial statements in that the portions of interest income, net charge-offs and certain components of other income related to the securitized loans against which beneficial interests have been issued are no longer recorded in our consolidated statements of income; however, they remain significant factors in determining the securitization income we receive on our retained beneficial interests in those transactions.

As described in Accounting Treatment for Off-Balance Sheet Securitizations, pursuant to new accounting guidance, the securitization trusts will be consolidated in our financial statements effective December 1, 2009. Beginning on that date, our results of operations will no longer reflect securitization income, but will instead report interest income, net charge-offs and certain other income associated with all securitized loan receivables and interest expense associated with debt issued to third-party investors in the same line items in our results of operations as non-securitized credit card loan receivables and corporate debt.

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Our senior management evaluates business performance and allocates resources using financial data that is presented on a managed basis. Managed loans consist of our on-balance sheet loan portfolio, loans held for sale and loan receivables that have been securitized and against which beneficial interests have been issued. Owned loans, a subset of managed loans, refer to our on-balance sheet loan portfolio and loans held for sale and include the undivided seller s interest we retain in our securitizations. A managed basis presentation, which is not a presentation in accordance with GAAP, involves reporting securitized loans with our owned loans in the managed basis statements of financial condition and reporting the earnings on securitized loans in the same manner as the owned loans instead of as securitization income. See GAAP to Managed Data Reconciliations.

2009 Highlights

Net income for 2009 was $1.3 billion, up from $0.9 billion in 2008, which includes $1.2 billion and $0.5 billion, respectively, of after tax income related to the Visa and MasterCard antitrust litigation settlement (described further in Legal Proceedings). Results for 2008 also include a $0.1 billion loss related to the sale of the Goldfish business in March 2008.

The challenging economic environment included increasing unemployment and higher consumer bankruptcies. As a result, net charge-off rates rose steadily throughout 2009 while delinquency rates remain elevated above prior periods. The net charge-off rate for 2009 was 7.45% on an owned basis (7.77% on a managed basis), compared to 4.59% on an owned basis in 2008 (5.01% on a managed basis). This increase in our net charge-off rates resulted in a $1.5 billion reduction of 2009 pretax income as compared to 2008. Additionally, our over 30 days delinquency rate at November 30, 2009, was 4.92% on an owned basis (5.31% on a managed basis), compared to 4.35% on an owned basis in 2008 (4.56% on a managed basis). In response to these trends, we increased the loan loss reserve rate throughout the year, from 5.45% at November 30, 2008 to 7.44% at November 30, 2009.

Despite the challenging economic environment, we maintained a steady level of managed receivables, and ended 2009 with $50.9 billion in managed loans compared to $51.1 billion at the end of 2008. However, owned loans fluctuated throughout the year as a result of securitization maturities and, in the second half of 2009, new securitization transactions. Credit card sales volumes were down 5% in 2009, largely due to lower gasoline prices but also due to the economic environment generally. This decline in sales, along with a lower level of promotional rate offers, contributed to a decline in managed credit card loans, which was largely offset by $2 billion of growth in our personal and student loan products and a lower payment rate on our credit card receivables.

During 2009, we took actions that resulted in higher net interest yield on loan receivables, including charging higher standard annual percentage rates and substantially reducing promotional rate offers. These actions, which were partially offset by a higher level of interest charge-offs, resulted in a net interest yield on loan receivables of 7.13% in 2009 (9.41% on a managed basis), up from 6.58% in 2008 (8.55% on a managed basis). This higher net interest yield along with a higher average level of owned loans contributed to $1.9 billion in net interest income for 2009 as compared to $1.4 billion in 2008.

We strengthened our liquidity and capital position through a number of capital market transactions during the year:

- In March 2009, through our participation in the U.S. Treasury s Capital Purchase Program, we issued and sold shares of our preferred stock and a warrant to purchase shares of our common stock to the U.S. Treasury for approximately $1.2 billion in cash and became a bank holding company;
- We raised $534 million in a common stock offering of approximately 60 million shares in July and August 2009;
- We raised a total of $1.1 billion in a senior debt offering in July 2009 and a subordinated debt offering in November 2009; and
- Our securitization trusts issued $2.8 billion of asset-backed securities funded under the Federal Reserve s Term Asset-Backed Securities Loan Facility (TALF) in July and September 2009.

We continued to grow our direct-to-consumer deposits and deposit products offered through affinity relationships, ending 2009 with $12.6 billion of these deposits, an increase of $6.4 billion from 2008. Our total funding from deposits, including brokered deposits, increased to $32.1 billion in 2009 from $28.5 billion in 2008.

We significantly reduced our operating expenses in 2009 by reducing promotional rate balance transfer offers and related marketing expenses, lowering headcount, and implementing several cost containment initiatives. As a result, our operating expenses decreased $165 million, or 7%, from 2008.

2008 and 2007 Highlights

We acquired Diners Club International (Diners Club) for $168 million on June 30, 2008. Diners Club has network licensees, which are generally financial institutions, that issue Diners Club branded credit cards and/or provide card acceptance services in over 185 countries and territories.

We sold our U.K. credit card business (Goldfish) to Barclays Bank PLC on March 31, 2008. This business represented substantially all of our International Card segment, which is presented in discontinued operations in this report.

On June 30, 2007, we spun off from Morgan Stanley through the distribution of shares of our common stock to holders of Morgan Stanley common stock. Our results of operations for the year ended November 30, 2007 include costs incurred as a result of the distribution of approximately $34 million, including costs that were allocated to the International Card segment, reported as discontinued operations in this report.

Outlook

The economic environment in 2009 was particularly challenging. Although we have seen some encouraging trends in certain economic indicators and in some of our own statistics, we have yet to see sustained economic improvement. In the last half of 2009, our charge-off and delinquency rates continued to rise, although not as quickly as they had risen in the last half of 2008 and into the first half of 2009, indicating that our loan losses might be approaching, but have not yet reached, their peak. We anticipate higher credit losses in 2010 and, given the continued uncertainty regarding the economic environment and somewhat higher level of delinquencies at the end of the fourth quarter 2009 compared to the end of the previous quarter, we increased our allowance for loan losses as a percentage of total loans to 7.44% at November 30, 2009. Additionally, our results in 2010 will not benefit from the Visa and MasterCard antitrust litigation settlement and will be adversely impacted by the new credit card legislation. See Legislative and Regulatory Developments below for a further discussion.

We anticipate that adjustments that we made to certain aspects of our business in 2009 in response to the current economic environment and the new credit card legislation will impact our 2010 financial results. Specifically, in the third quarter 2009, we made changes to new and existing accounts, such as increasing standard annual percentage rates and converting many accounts with fixed rates to variable rates. The higher rates charged on standard balances along with a decline in the level of promotional rate offers during the year had a positive impact on our 2009 net interest yield on credit card loan receivables. Although the benefit of these actions will continue to accumulate in 2010, the impact will not be as significant as in 2009 and will also be offset by all of the restrictions under the CARD Act, as described below. We expect to maintain our current level of loan receivables through emphasizing our *Cashback Bonus* rewards program, our customer service and our other lending products, including student and personal loans.

We also took certain actions to reduce our operating expenses in 2009, which included reducing headcount. We plan to invest in marketing and other initiatives to grow our deposit products and our network capabilities, but we will continue to focus on sustaining a lower level of overall operating expenses compared to prior years.

At November 30, 2009, we had increased our liquidity reserve, primarily consisting of cash and cash equivalents, to $14.2 billion, in anticipation of approximately $12.5 billion of asset-backed securities and deposit maturities in the first half of 2010. In 2009, we relied principally on deposits to fund our business, experiencing $3.6 billion growth in our total deposit balance at November 30, 2009 as compared to November 30, 2008, while our level of securitization borrowings from third parties declined by approximately $2.2 billion. In 2010, we plan to continue to grow deposits, particularly direct-to-consumer deposits, as a percentage of our total funding by using both organic and inorganic methods. Our ability to issue asset-backed securities in 2010 depends on a number of factors, including market liquidity as well as legislative and regulatory developments.

In 2009, we issued $1.2 billion of senior preferred stock and a warrant to purchase shares of our common stock to the U.S. Treasury under the CPP. We subsequently raised a total of $1.6 billion in various capital market transactions. We also increased our capital in 2009 through growth in retained earnings. Going forward, as we continue to evaluate our capital levels, we will also evaluate our continued participation in the CPP and we intend, at the appropriate time, subject to the approval of the Federal Reserve, to repurchase our preferred stock from the U.S. Treasury.

In our payments business, we continue to focus on increasing global volume across the Discover, PULSE and Diners Club networks by leveraging our flexibility, network relationships and emerging payments opportunities. This effort includes the rapid implementation of our U.S. acceptance strategy, which is based on increasing the number of active merchants who accept Discover through the numerous acquiring relationships we have built in recent years. Outside the U.S., we will continue to work with various Diners Club licensees, acquirers and other payment networks to grow volume and continue the expansion of our acceptance footprint, which includes the global cash access network we launched in 2009. In 2010, we expect to make investments in an attempt to grow volume and market share for our payments business around the world.

Accounting Treatment for Off-Balance Sheet Securitizations

In June 2009, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets-an amendment of FASB Statement No. 140* (Statement No. 166) and Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* (Statement No. 167). In December 2009, Statement No. 166 was codified within the FASB Accounting Standards Codification under Section 860, *Transfers and Servicing*, and Statement No. 167 was codified within Section 810, *Consolidation*. For ease of reference, and to clarify between guidance applicable as of the date of the accompanying financial statements and guidance applicable to future periods, we will continue to refer to Statements No. 166 and 167 under their previous names within this document. Statement No. 166 amends the accounting for transfers of financial assets and will impact the accounting for our credit card asset securitization activities. Under Statement No. 166, the trusts used in our securitization transactions will no longer be exempt from consolidation. Statement No. 167 prescribes an ongoing assessment of our involvement in the activities of the trusts and our rights or obligations to receive benefits or absorb losses of the trusts that could be potentially significant in order to determine whether those entities will be required to be consolidated on our financial statements. The assessment under Statement No. 167, which became effective for us on December 1, 2009, will result in the consolidation of the trusts by us as of that date. Using the carrying amounts of the trust assets and liabilities as prescribed by Statement No. 167, we expect to record a $21.1 billion increase in total assets, a $22.4 billion increase in total liabilities and a $1.3 billion decrease in stockholders equity (comprised of a $1.4 billion decrease in retained earnings offset by an increase of $0.1 billion in other comprehensive income).

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The following table shows significant line items on our consolidated statement of financial condition on an actual and pro forma basis, the latter of which gives effect to adjustments expected to be recorded on December 1, 2009 in connection with adopting Statements No. 166 and 167. The adoption of Statements No. 166 and 167 requires a full consolidation of the trusts in accordance with GAAP, which is different from a managed presentation. For further discussion of these differences, see GAAP to Managed Data Reconciliations.

	November 30, 2009 Actual Balance Sheet	November 30, 2009 Pro Forma Balance Sheet[(1)]
	(dollars in millions)	
Assets		
Cash and cash equivalents	$ 13,021	$ 13,021
Restricted cash	643	1,882
Investment securities	5,035	534
Loan receivables, gross	23,625	50,854
Allowance for loan losses	(1,758)	(3,902)
Loan receivables, net	21,867	46,952
Amounts due from asset securitization	1,692	
Deferred tax assets	790	1,578
Other assets	2,973	3,151
Total assets	$ 46,021	$ 67,118
Liabilities and Stockholders Equity		
Deposits	$ 32,093	$ 32,093
Long-term borrowings	2,428	24,760
Other liabilities	3,064	3,162
Total liabilities	37,585	60,015
Total stockholders equity	8,436	7,103
Total liabilities and stockholders equity	$ 46,021	$ 67,118

(1) When presented in financial reports beginning in 2010, assets and liabilities of the securitization trusts will be separately presented on the face of the balance sheet, as required by Statement No. 167, to reflect the facts that trust assets can be used only to settle trust obligations and that the trusts creditors (or beneficial interest holders) do not have recourse to the general credit of the Company.

The pro forma balance sheet as of November 30, 2009 shown above reflects the following adjustments:

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

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

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

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

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

After adoption, our results of operations will no longer reflect securitization income, but will instead report interest income, net charge-offs and certain other income associated with all securitized loan receivables and interest expense associated with debt issued from the trusts to third-party investors in the same line items in our results of operations as non-securitized credit card loan receivables and corporate debt. Additionally, after adoption, we will no longer record initial gains on new securitization activity since securitized credit card loans will no longer receive sale accounting treatment, nor will there be any gains or losses on the revaluation of the interest-only strip receivable as that asset is not

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recognizable in a transaction accounted for as a secured borrowing. Because our securitization transactions will be accounted for under the new accounting rules as secured borrowings rather than asset sales, the cash flows from these transactions will be presented as cash flows from financing activities rather than cash flows from operating or investing activities. Notwithstanding this accounting treatment, our securitizations are structured to legally isolate the receivables from Discover Bank and we would not expect to be able to access the assets of our securitization trusts, even in insolvency, receivership or conservatorship proceedings. We would, however, continue to have the rights associated with our retained interests in these trusts.

Actions we took in the third quarter of 2009 to adjust the credit enhancement structure of the trusts had the effect of causing the assets of the trusts to be included in our risk-weighted assets for regulatory capital purposes effective July 2009. As a result, the consolidation of the trusts under Statement No. 167 on December 1, 2009, had a lesser impact on our regulatory capital calculations than would have otherwise been the case because much of this effect has already been reflected as a result of the trust actions. See Liquidity and Capital Resources Funding Sources Securitization Financing below for further discussion of these trust support actions. However, the $1.4 billion charge to retained earnings as a result of adopting Statement No. 167 will further reduce our regulatory capital ratios, although both Discover Financial Services and Discover Bank are expected to remain above well-capitalized levels after the adoption of Statements No. 166 and 167. The following table shows our regulatory capital amounts and ratios on an actual and pro forma basis as of November 30, 2009, the latter of which gives effect to the estimated $1.4 billion reduction of retained earnings expected to be recorded on December 1, 2009 in connection with adopting Statements No. 166 and 167:

	November 30, 2009	**November 30, 2009**
	Actual	**Pro Forma**
	(dollars in thousands)	
Discover Financial Services		
Total Capital	$ 9,516,965	$ 8,104,091
Tier 1 Capital	$ 8,139,309	$ 6,728,192
Total Risk-Based Capital Ratio	17.9%	15.9%
Tier 1 Risk-Based Capital Ratio	15.3%	13.2%
Tier 1 Leverage Ratio	18.1%	10.2%
Discover Bank		
Total Capital	$ 8,210,450	$ 6,797,568
Tier 1 Capital	$ 6,572,320	$ 5,161,203
Total Risk-Based Capital Ratio	15.8%	13.7%
Tier 1 Risk-Based Capital Ratio	12.6%	10.4%
Tier 1 Leverage Ratio	15.9%	8.3%

Legislative and Regulatory Developments

Legislation Addressing Credit Card Practices

In May 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the CARD Act) was enacted. The CARD Act makes numerous changes to the Truth in Lending Act, affecting the marketing, underwriting, pricing, billing and other aspects of the consumer credit card business. Several provisions of the CARD Act became effective in August 2009, but most of the requirements will become effective in February 2010 and others will become effective in August 2010. Legislation has been proposed to accelerate the effective date of all of the CARD Act provisions effective as soon as the legislation is enacted, but prospects for enactment are uncertain. The CARD Act and its implementing regulations:

- Prohibit interest rate increases on outstanding balances except under limited circumstances;

- Prohibit interest rate increases on new balances during the first year an account is opened except under limited circumstances;

Require allocation of payments in excess of the required minimum payment to balances with the highest annual percentage rate (APR) before balances with a lower APR (for accounts with different APRs on different balances);

Restrict imposition of a default APR on existing balances unless an account is 60 days past due and require that the increased APR resulting from a default be reduced if payments are timely made for six months;

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- Generally require 45 days advance notice be provided prior to increasing any APR (as permitted by the CARD Act) or other significant changes to account terms. Except for certain changes, the notice must include a statement of the cardholder s right to cancel the account prior to the effective date of the change;

- Prohibit the use of the two-cycle average daily balance method of calculating interest and prohibit the assessment of interest on any portion of a balance that is repaid within the grace period;

- Require penalty fees (e.g., late fees and over-limit fees) to be reasonable and proportional to the consumer s violation of the account terms;

- Prohibit card issuers from imposing over-limit fees unless the cardholder has expressly opted-in to the issuer authorizing such over-limit transactions, and imposes other limits on such fees;

- Require card issuers to review accounts at least every six months when an APR has been increased to determine whether the APR should be reduced;

- Prohibit issuance of a credit card to a consumer under the age of 21 unless there is a co-signer over the age of 21 who has a means to repay or the individual under the age of 21 has an independent means to repay; and

- Require new billing statement disclosures, such as the length of time and cost of paying down the account balances if only minimum payments are made.

A number of the CARD Act s requirements reflect our existing practices and will not require modifications of policies or procedures. Restrictions on risk management practices that have been commonplace in the industry already have compelled us, and our competitors, to manage risk through more restrictive underwriting and credit line management, reduce promotional offers and increase annual percentage rates. Certain provisions of the CARD Act, however, such as those addressing limitations on interest rate increases, late and over-limit fees and payment allocation, are requiring us to make additional fundamental changes to our current business practices and systems. For example, we have informed our credit card customers that as of certain specified dates we will no longer charge over-limit fees, impose fees for payments made over the telephone, or change interest rates on existing balances when a customer s payments are late.

Full implementation of the CARD Act requires the promulgation of regulations by the Federal Reserve. The Federal Reserve has issued final regulations implementing the majority of the provisions of the CARD Act. We are making changes that the CARD Act requires to be implemented in a relatively short timeframe. Other changes must await final regulatory guidance from the Federal Reserve. We are continuing to evaluate appropriate modifications to products, revenue generation, marketing strategies and other business practices that will be in compliance with the law, will be attractive to consumers and will provide a good return for our stockholders. The full impact of the CARD Act on us is unknown at this time as it ultimately depends upon Federal Reserve interpretation of some of the provisions, successful implementation of our strategies, consumer behavior, and the actions of our competitors.

The CARD Act also requires the Federal Reserve and the Government Accountability Office to conduct various studies, including studies regarding interchange fees, reasons for credit limit reductions and rate increases, small business cards, and credit card terms and disclosures. Based on the results of these studies, new requirements that negatively impact us may be introduced as future legislation or regulation.

Other Credit Card and Student Loan Legislation

Congress may also consider other legislation affecting our business. Examples include a ceiling on the rate of interest that can be charged on credit cards, restrictions on interchange fees and merchant rules established by the credit card networks, authority for merchants to provide discounts to customers who use certain types of credit or debit cards, and extending the provisions of the CARD Act to business cards.

We currently offer both federal and private student loans. In September 2009, the U.S. House of Representatives passed the Student Aid and Fiscal Responsibility Act (SAFRA), which is currently under consideration in the U.S. Senate. If passed in its current form, SAFRA would require all federal student loans to be made directly by the federal government starting July 2010, rather than by private institutions through the

Federal Family Education Loan Program. Because SAFRA allows financial institutions to continue offering private student loans, we do not expect SAFRA to have an impact on our ability to continue offering private student loans, even if we discontinue offering student loans under federal programs.

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Bankruptcy Legislation

The Senate Judiciary Committee continues to consider legislation that would disallow claims in Chapter 7 bankruptcy based on high cost consumer debt and exclude consumers with such debt from the bankruptcy means test. The means test requires debtors who can afford to repay a portion of their debts through Chapter 13 repayment plan do so, rather than discharge all indebtedness under Chapter 7. The proposed legislation, if enacted, could increase the percentage of bankruptcy filers who obtain full debt discharges to the detriment of all unsecured lenders, and could result in increased charge-offs of our loan receivables. It is unclear whether this legislation will be enacted by Congress.

Congress also continues to consider legislation to allow bankruptcy courts to restructure first mortgage loans (e.g., by reducing the loan amount to the value of the collateral, a process referred to as cramdown). This change is likely to increase the number of individuals who file for bankruptcy, which would adversely impact all creditors including us. While the House of Representatives has approved a cramdown bill, it has garnered significant opposition in the Senate and prospects for enactment are unclear.

Financial Regulatory Reform

Reacting to the financial crisis and proposals from the Administration, Congress is considering extensive changes to the laws regulating financial services firms. In December 2009, the House of Representatives approved the Wall Street Reform and Consumer Protection Act. The Senate Banking Committee plans to consider its own version of financial regulatory reform legislation in February.

The bills, though different at present, address risks to the economy and the payments system, especially those posed by large systemically significant financial firms, through a variety of measures, including regulatory oversight of nonbanking entities, increased capital requirements, enhanced authority to limit activities and growth, changes in supervisory authority, resolution authority for failed financial firms (and the establishment of a fund to pay for the costs financed by assessments on financial firms with more than $10 billion in assets), enhanced regulation of derivatives and asset-backed securities (e.g., requiring loan originators to retain at least 5% of the credit risk of securitized exposures), restrictions on executive compensation, and oversight of credit rating agencies. Both bills contain versions of a new independent Consumer Financial Protection Agency (CFPA) that would regulate consumer financial services and products, including credit, savings and payment products to prevent unfair, deceptive or abusive practices, promote product simplicity and ensure equal access to financial products. The CFPA would have sole rulemaking and interpretive authority under existing and future consumer financial services laws and supervisory, examination and enforcement authority over institutions subject to its regulations. The bills would limit the ability of federal laws to preempt state and local law. The President has made the enactment of financial reform legislation a priority, although there is significant opposition to several components, including the creation of a CFPA. Passage of the bills in their present form would have a material adverse impact on us, but prospects for approval of the legislation, and the content of a final bill, are unclear.

Additionally, in January 2010, the Administration announced plans to propose a Financial Crisis Responsibility Fee over a ten-year period on large financial firms to offset the cost of the U.S. Treasury s Troubled Asset Relief Program. As currently outlined, we would be subject to the fee because the size of our balance sheet will exceed the $50 billion threshold established by the proposal after the adoption of newly applicable accounting guidance related to consolidation. As proposed, qualifying institutions would pay 15 basis points on total assets less Tier 1 capital and deposits, beginning June 30, 2010. Whether the fee will be implemented, and in what form, is uncertain.

Compensation Developments

In June 2009, the U.S. Treasury issued interim final rules implementing the compensation and corporate governance requirements under the American Recovery and Reinvestment Act of 2009, which amended the requirements of the Emergency Economic Stabilization Act of 2008, as amended (EESA), as described in our quarterly report for the quarter ended February 28, 2009. The rules apply to us as of June 2009 as a recipient of funds under the U.S. Treasury s Capital Purchase Program. These rules were subject to a public comment period which has expired, but no final rule has been adopted.

The rules, among other things, set forth prohibitions on incentive compensation payments, provide guidance on the use of restricted stock units, expand restrictions on golden parachute payments, mandate enforcement of clawback provisions unless unreasonable to do so, outline the steps compensation committees must take when evaluating risks posed by compensation arrangements, require the adoption and disclosure of a luxury expenditure policy, and require compliance with federal securities rules and regulations allowing stockholders to have a non-binding advisory vote on executive compensation. Under rules issued by the SEC pursuant to EESA, we, as a participant in the Capital Purchase Program, will be required to include a non-binding, advisory shareholder vote on the compensation of our executives, as set forth in the compensation discussion and analysis, the compensation tables, and any related material in our proxy statement, at our annual meeting in April. Additionally, new requirements under the U.S. Treasury s rules include enhanced disclosure of perquisites and the use of compensation consultants, and a prohibition on tax gross-up payments.

In October 2009, the Federal Reserve issued proposed supervisory guidance designed to ensure that incentive compensation practices of banking organizations are consistent with safety and soundness. The proposed guidance was subject to a public comment period which has expired, but no final guidance has been issued. The Federal Reserve has also commenced a special horizontal review of compensation practices at 28 large complex banking organizations, including us.

The financial regulatory reform bill approved by the House of Representatives in December 2009, which is described above, would impose additional disclosures and restrictions on compensation paid by financial institutions if enacted. The bill also would require the regulation of inappropriate or imprudently risky compensation practices.

FDIC Rule Regarding Securitizations

While we have capacity to issue new asset-backed securities from our securitization trusts, there has been uncertainty in the securitization market recently as a result of revised accounting standards and related guidance from the FDIC. The ability of issuers of asset-backed securities to obtain necessary credit ratings for their issuances has been based, in part, on the FDIC s rule entitled *Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation*, which provides that the FDIC will not seek to reclaim or recover assets transferred in connection with a securitization, or recharacterize them as assets of the insured depository institution, provided such transfer meets the conditions for sale accounting treatment under GAAP. Pursuant to FASB guidance for transfers of financial assets, effective for us on December 1, 2009, certain transfers of assets to special purpose entities (including Discover Bank s transfer of assets to the Discover Card Master Trust) no longer qualify for sale accounting treatment. Consequently, there has been uncertainty in the securitization market as to how the FDIC will treat assets transferred into securitization vehicles under the new FASB guidance. This uncertainty had made it difficult or impossible to obtain the necessary credit ratings for the issuances of asset-backed securities, including the required ratings for securities to qualify as eligible securities under TALF.

In November 2009, the FDIC issued an interim final rule that preserves the legal isolation treatment applicable under the existing FDIC rule for asset-backed securities issued on or prior to March 31, 2010, which is the date that TALF expires. Issuances after this date are subject to the final determination of the FDIC regarding the legal isolation standard, the potential framework of which was described in the FDIC s Advance Notice of Proposed Rulemaking in December 2009. The form that this rule will ultimately take is uncertain at this time, but it may impact our ability and/or desire to issue asset-backed securities in the future.

FDIC Rule Regarding Assessments

Market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. As a result, we may be required to pay significantly increased premiums or additional special assessments. In 2009, we paid $15.8 million for a special industry-wide FDIC deposit insurance assessment. The FDIC has finalized a proposal that requires banks to prepay their FDIC insurance premiums for the years 2010 through 2012. On December 30, 2009, we prepaid $185.5 million, which includes all of our quarterly assessments, typically paid one quarter in arrears, for the calendar quarters ending December 31, 2009 through December 31, 2012. Additionally, in January 2010, the FDIC issued an Advance Notice of Proposed Rulemaking seeking comment on ways that the FDIC s risk-based deposit insurance assessment system could be changed to account for the risks posed by certain employee compensation programs.

* * *

The remaining discussion provides a summary of our results of operations for the years ended November 30, 2009, 2008 and 2007, as well as our financial condition at November 30, 2009 and 2008. All information and comparisons are based solely on continuing operations.

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Segments

We manage our business activities in two segments: Direct Banking, formerly referred to as U.S. Card, and Payment Services, formerly referred to as Third-Party Payments. We have changed the names of our segments to better reflect the nature of the products and services included in our segments. The composition of each segment, however, has not changed.

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

Direct Banking. Our Direct Banking segment includes Discover card-branded credit cards issued to individuals and small businesses on the Discover Network and other consumer products and services, including personal loans, student loans, prepaid cards and other consumer lending and deposit products offered through our Discover Bank subsidiary.

Payment Services. Our Payment Services segment includes the PULSE Network (PULSE), an automated teller machine, debit and electronic funds transfer network; Diners Club, a global payments network; and our third-party issuing business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties.

The following table presents segment data on a managed basis and a reconciliation to a GAAP presentation (dollars in thousands):

	Managed Basis				GAAP Basis
For the Years Ended November 30,	Direct Banking	Payment Services(1)	Total	Securitization Adjustment(2)	Total
2009					
Interest income	$ 6,459,974	$ 1,098	$ 6,461,072	$ (3,315,992)	$ 3,145,080
Interest expense	1,648,198	222	1,648,420	(397,136)	1,251,284
Net interest income	4,811,776	876	4,812,652	(2,918,856)	1,893,796
Provision for loan losses	4,358,341		4,358,341	(1,995,936)	2,362,405
Other income(3)	3,677,881	239,794	3,917,675	922,920	4,840,595
Other expense	2,116,962	134,126	2,251,088		2,251,088
Income from continuing operations before income tax expense	$ 2,014,354	$ 106,544	$ 2,120,898	$	$ 2,120,898
2008					
Interest income	$ 6,542,664	$ 3,165	$ 6,545,829	$ (3,853,266)	$ 2,692,563
Interest expense	2,356,836	83	2,356,919	(1,068,915)	1,288,004
Net interest income	4,185,828	3,082	4,188,910	(2,784,351)	1,404,559
Provision for loan losses	3,068,604		3,068,604	(1,472,989)	1,595,615
Other income(3)	2,773,896	179,200	2,953,096	1,311,362	4,264,458
Other expense	2,314,926	100,871	2,415,797		2,415,797
Income from continuing operations before income tax expense	$ 1,576,194	$ 81,411	$ 1,657,605	$	$ 1,657,605
2007					
Interest income	$ 6,376,298	$ 2,376	$ 6,378,674	$ (3,794,272)	$ 2,584,402
Interest expense	2,741,109	19	2,741,128	(1,517,858)	1,223,270
Net interest income	3,635,189	2,357	3,637,546	(2,276,414)	1,361,132
Provision for loan losses	1,853,395		1,853,395	(1,119,508)	733,887
Other income	2,101,076	118,700	2,219,776	1,156,906	3,376,682
Other expense	2,394,117	84,097	2,478,214		2,478,214

Income from continuing operations before income tax expense	$ 1,488,753	$ 36,960	$ 1,525,713	$	$ 1,525,713

(1) Diners Club was acquired on June 30, 2008.
(2) The Securitization Adjustment column presents the effects of loan securitizations by recharacterizing as securitization income the portions of the following items that relate to the securitized loans: interest income, interest expense, provision for loan losses, discount and interchange revenue and loan fee revenues. Securitization income is reported in other income.
(3) The years ended November 30, 2009 and 2008 include $1.9 billion and $0.9 billion, respectively, of income related to the Visa and MasterCard antitrust litigation settlement, which is included in our Direct Banking segment. See Legal Proceedings.

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

	For the Years Ended November 30,		
	2009	2008	2007
Network Transaction Volume			
PULSE Network	$ 109,302,121	$ 106,012,108	$ 86,236,408
Third-Party Issuers	5,671,555	6,398,579	5,480,105
Diners Club(1)	26,172,977	12,685,690	
Total Payment Services	141,146,653	125,096,377	91,716,513
Discover Network Proprietary(2)	90,688,997	95,688,443	93,794,500
Total Volume	$ 231,835,650	$ 220,784,820	$ 185,511,013
Transactions Processed on Networks			
Discover Network	1,513,955	1,515,368	1,486,366
PULSE Network	2,878,720	2,682,312	2,285,061
Total	4,392,675	4,197,680	3,771,427
Credit Card Volume			
Discover Card Volume(3)	$ 95,592,170	$ 105,734,055	$ 106,620,818
Discover Card Sales Volume(4)	$ 87,460,552	$ 92,239,779	$ 90,262,556

(1) Diners Club was acquired on June 30, 2008. Diners Club volume is derived from data provided by licensees for Diners Club branded cards issued outside North America and is subject to subsequent revision or amendment.
(2) Represents gross proprietary sales volume on the Discover Network.
(3) Represents Discover card activity related to net sales, balance transfers, cash advances and fee-based products.
(4) Represents Discover card activity related to net sales.

The segment discussions that follow for the years ended November 30, 2009, 2008 and 2007 are on a managed basis.

Direct Banking

Our Direct Banking segment, formerly referred to as our U.S. Card segment, reported pretax income of $2.0 billion for the year ended November 30, 2009, up 28% from the year ended November 30, 2008. The increase was driven principally by income related to the Visa and MasterCard antitrust litigation settlement, higher net interest income and lower operating expenses, partially offset by higher provision for loan losses. Net interest income increased $625.9 million, or 15%, due to the impact of higher interest rates on standard balances, a substantial reduction in promotional rate balances and lower interest rates on borrowings, partially offset by higher interest charge-offs. Provision for loan losses increased $1.3 billion, or 42%, as a result of higher charge-offs and a higher reserve rate, reflective of the current economic environment. Other income increased $0.9 billion mainly due to revenue related to the Visa and MasterCard antitrust litigation settlement. Other expense decreased $198.0 million, or 9%, reflecting the impact of cost containment initiatives such as a reduction of headcount, lower marketing and lower litigation expenses. The 2008 other expenses included a $38.9 million benefit due to curtailment of the company s pension plan.

Managed loans of $50.9 billion at November 30, 2009 were relatively unchanged from November 30, 2008 as lower payments from our credit card customers and growth in both student and personal loans were largely offset by lower balance transfer activity and sales volume. Rising unemployment and bankruptcy levels adversely impacted customer delinquencies and charge-offs, resulting in a 5.31% managed over 30 days delinquency rate for the segment, including non-credit card loans, up from 4.56% at November 30, 2008. For the year ended November 30, 2009, the managed segment and credit card net charge-off rates were 7.77% and 8.00%, respectively, up 276 basis points and 293 basis points, respectively, from the year ended November 30, 2008.

Our Direct Banking segment reported pretax income of $1.6 billion for the year ended November 30, 2008, up $87.4 million, or 6%, as compared to November 30, 2007. The increase in pretax income was driven principally by payment from MasterCard for its portion of the Visa and MasterCard antitrust litigation settlement and by higher net interest income, partially offset by higher provision for loan losses. Net interest income increased $550.6 million, or 15%, as higher average loan receivables and the accretion of balance transfer fees, previously recorded in loan fee income,

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resulted in higher interest income. Net interest income also benefited from lower interest expense driven by a lower cost of funds, which was partially offset by higher borrowings to fund higher loan receivables, higher interest charge-offs and lower investment income. Provision for loan losses increased $1.2 billion, or 66%, as a result of higher net charge-offs and a higher reserve rate, each of which reflected the deterioration in economic conditions and delinquency trends, as well as owned loan growth due to maturing securitizations. Other income increased $672.8 million, or 32%, due to the payment from MasterCard for its portion of the Visa and MasterCard antitrust litigation settlement and an increase in discount and interchange revenue. These were partially offset by a $119.3 million write-down of the interest-only strip receivable and the inclusion of balance transfer fees in interest income beginning in the third quarter of 2008. Other expenses decreased $79.2 million, or 3%, primarily due to a $38.9 million benefit from our pension curtailment, a lower level of marketing for new account acquisition and promotional activity, and a decrease in costs related to litigation.

The managed loan balance of $51.1 billion at November 30, 2008 was up 6% from November 30, 2007. This increase in loans was attributable to lower customer payments, growth in personal and student loans during the year and a slight increase in credit card volume, up 2% in 2008, largely due to higher gasoline prices. This increase was partially offset by lower balance transfer activity in 2008. The weakening economic environment adversely impacted customer delinquencies and charge-offs. The managed over 30 days delinquency rate for the segment, including non-credit card loans, was 4.56% at November 30, 2008, 98 basis points higher than the comparable prior year. For the year ended November 30, 2008, the managed segment and credit card charge-off rates were 5.01% and 5.07%, up 118 and 123 basis points from the comparable prior year periods, respectively. Our loan growth combined with the deterioration in the credit environment led to a $614.7 million increase to our reserves over and above our net charge-offs for the year ended November 30, 2008.

Payment Services

Revenues, expenses, pretax income and transaction volumes in our Payment Services segment, formerly referred to as our Third-Party Payments segment, grew significantly in 2009 from 2008. 2009 volumes benefited from the inclusion of Diners Club transaction volume for the full year in addition to higher activity from new and existing financial institutions on the PULSE Network. These were partially offset by the loss of volume from one large financial institution along with lower third-party issuer volume as a result of lower gasoline prices and lower overall spending.

Our Payment Services segment reported pretax income of $106.5 million for the year ended November 30, 2009, up $25.1 million as compared to the year ended November 30, 2008. Revenues were up $60.6 million mainly driven by increased transactions on the PULSE Network, along with lower incentive payments and higher fee revenue. Expenses were also up $33.3 million including a higher level of international marketing investments, partially offset by the impact of cost containment initiatives. Additionally, the increase in both revenues and expenses during 2009 is due to the inclusion of Diners Club for the full year.

Our Payment Services segment reported pretax income of $81.4 million for the year ended November 30, 2008, up $44.5 million as compared to the year ended November 30, 2007. Revenue increased as a result of a record $125.1 billion in segment transaction volume, up 36% from 2007, and higher fee revenues. Additionally, in 2008, Diners Club contributed $12.7 billion of transaction volume, $27.7 million of revenues and $10.7 million of pretax income.

GAAP to Managed Data Reconciliations

Our senior management evaluates business performance and allocates resources using financial data that is presented on a managed basis. Securitized loans against which beneficial interests have been issued to third parties are removed from our GAAP statements of financial condition. Instances in which a wholly-owned subsidiary of Discover Bank acquires certificated beneficial interests in securitization transactions result in a reduction to loan receivables of the amount of the acquired beneficial interest and a corresponding increase in investment securities. The portions of interest income, provision for loan losses and certain components of other income related to the securitized loans against which beneficial interests have been issued are no longer recorded in our GAAP statements of income; however, they remain significant factors in determining the securitization income we receive on our retained beneficial interests in those transactions.

The managed basis presentation generally reverses the effects of securitization transactions; however, there are certain assets that arise from securitization transactions that are not reversed. Specifically, these assets are the cash collateral accounts that provide credit enhancement to the investors in certain transactions and payments made by our credit card

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customers which are allocated to the securitized loans, both of which are held at the trusts. These assets also include the interest-only strip receivable, which reflects the estimated fair value of the excess cash flows allocated to securitized loans and retained certificated beneficial interests. Income derived from these assets representing interest earned on accounts at the trusts, changes in the fair value of the interest-only strip receivable, and interest income on investment securities also are not reversed in a managed presentation.

Managed loan data is relevant because we service the securitized and owned loans, and the related accounts, in the same manner without regard to ownership of the loans. Management believes it is useful for investors to consider the credit performance of the entire managed loan portfolio to understand the quality of loan originations and the related credit risks inherent in the owned portfolio and retained interests in securitizations. Loan receivables on a GAAP (or owned) basis and related performance measures, including yield, charge-offs and delinquencies can vary from those presented on a managed basis. Generally, loan receivables included in the securitization trusts are derived from accounts that are more seasoned, while owned loan receivables represent a greater concentration of newer accounts. The seasoning of an account is measured by the age of the account relationship. In comparison to more seasoned accounts, loan receivables of newer accounts typically have lower charge-offs and delinquencies and carry lower interest yields resulting from introductory offers to new credit card customers, though such offers have been substantially reduced in recent periods.

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Financial measures using managed data are non-GAAP financial measures. Beginning with Earnings Summary, the discussion of our results of operations and financial condition is on a GAAP basis. The following table provides a reconciliation of the loan receivables and related statistics that are impacted by asset securitization, and which are shown on a managed basis in this annual report, to the most directly comparable GAAP-basis financial measure:

Reconciliation of GAAP to Managed Data

	For the Years Ended November 30,		
	2009	2008	2007
	(dollars in thousands)		
Loan Receivables			
Total Loans			
GAAP Basis	$ 23,625,084	$ 25,216,611	$ 20,831,117
Securitization Adjustment	27,235,288	25,878,667	27,349,319
Managed Basis	$ 50,860,372	$ 51,095,278	$ 48,180,436
Average Total Loans			
GAAP Basis	$ 26,552,574	$ 21,348,493	$ 19,947,784
Securitization Adjustment	24,588,040	27,662,655	26,965,690
Managed Basis	$ 51,140,614	$ 49,011,148	$ 46,913,474
Interest Yield			
GAAP Basis	11.31%	10.89%	10.73%
Securitization Adjustment	13.49%	13.93%	14.07%
Managed Basis	12.36%	12.61%	12.65%
Net Principal Charge-off Rate			
GAAP Basis	7.45%	4.59%	3.40%
Securitization Adjustment	8.12%	5.32%	4.15%
Managed Basis	7.77%	5.01%	3.83%
Delinquency Rate (over 30 days)			
GAAP Basis	4.92%	4.35%	3.26%
Securitization Adjustment	5.65%	4.77%	3.82%
Managed Basis	5.31%	4.56%	3.58%
Delinquency Rate (over 90 days)			
GAAP Basis	2.58%	2.06%	1.51%
Securitization Adjustment	2.95%	2.27%	1.79%
Managed Basis	2.78%	2.17%	1.67%
Credit Card Loans			
GAAP Basis	$ 20,230,302	$ 23,814,307	$ 20,579,923
Securitization Adjustment	27,235,288	25,878,667	27,349,319
Managed Basis	$ 47,465,590	$ 49,692,974	$ 47,929,242
Average Credit Card Loans			
GAAP Basis	$ 24,266,782	$ 20,566,864	$ 19,845,880
Securitization Adjustment	24,588,040	27,662,655	26,965,690
Managed Basis	$ 48,854,822	$ 48,229,519	$ 46,811,570
Interest Yield			
GAAP Basis	11.69%	10.92%	10.75%
Securitization Adjustment	13.49%	13.93%	14.07%
Managed Basis	12.59%	12.65%	12.66%
Net Principal Charge-off Rate			
GAAP Basis	7.87%	4.73%	3.41%
Securitization Adjustment	8.12%	5.32%	4.15%

Managed Basis	8.00%	5.07%	3.84%
Delinquency Rate (over 30 days)			
GAAP Basis	5.52%	4.55%	3.28%
Securitization Adjustment	5.65%	4.77%	3.82%
Managed Basis	5.60%	4.66%	3.59%
Delinquency Rate (over 90 days)			
GAAP Basis	2.92%	2.16%	1.53%
Securitization Adjustment	2.95%	2.27%	1.79%
Managed Basis	2.94%	2.22%	1.68%

Critical Accounting Estimates

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

Allowance for Loan Losses

The allowance for loan losses represents management s estimate of probable net loan losses inherent in the loan portfolio. Management evaluates the allowance monthly for adequacy. The allowance is maintained through an adjustment to the provision for loan losses. In estimating losses inherent in the credit card loan portfolio, we use an approach that utilizes a migration analysis of delinquent and current credit card receivables. A migration analysis is a technique used to estimate the likelihood that a loan receivable will progress through the various stages of delinquency and to charge-off. The migration analysis considers uncollectible principal, interest and fees reflected in loan receivables. In determining the proper level of the allowance for loan losses, management also considers factors that may impact loan loss experience, including current economic conditions, recent trends in delinquencies and bankruptcy filings, account collection management, policy changes, account seasoning, loan volume and amounts, payment rates and forecasting uncertainties.

If management used different assumptions in estimating probable losses, the impact to the allowance for loan losses could have a material effect on our consolidated financial condition and results of operations. For example, a 10% change in management s estimate of probable net loan losses could have resulted in a change of approximately $176 million in the allowance for loan losses at November 30, 2009, with a corresponding change in the provision for loan losses. See Note 5: Loan Receivables to our consolidated financial statements for further details about the allowance for loan losses.

Accounting for Asset Securitization Transactions

We account for our securitization transactions in accordance with FASB Accounting Standards Codification (ASC) Topic 860, *Transfers of Financial Assets*. The gain on a securitization transaction depends in part on the previous carrying amount of the assets involved in the transfer, allocated between the assets transferred and the retained interests based upon their respective fair values at the date of the transfer. The interest-only strip receivable represents the contractual right to receive interest and certain loan fee revenues less certain costs, including loan losses on securitized loans and the contractual rate of interest paid to third-party investors in the securitization as well as a servicing fee from the trust over the life of the asset sold. In the absence of observable market prices, the fair value of the interest-only strip receivable is estimated based on the present value of expected future cash flows using management s best estimate of the key assumptions, including forecasted interest yield, loan losses and payment rates, the interest paid to investors and a discount rate commensurate with the risks involved. Changes in the estimated fair value of the interest-only strip receivable, as well as certain other retained interests, are recorded in securitization income.

If management used different assumptions in estimating the value of the interest-only strip receivable, the impact could have a material effect on our consolidated financial condition and results of operations. For example, a 10% change in the excess spread assumption for all securitized loans could have resulted in a change of approximately $8 million in the value of the interest-only strip receivable as of November 30, 2009. However, as described in Accounting Treatment for Off-Balance Sheet Securitizations, pursuant to new FASB guidance related to transfers of financial assets and consolidation, the securitized loans will be consolidated in the Company s financial statements effective December 1, 2009, at which time the entire value of the interest-only strip receivable will be derecognized. See Note 6: Credit Card Securitization Activities to our consolidated financial statements for further information about the accounting for securitizations.

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Valuation of Certificated Retained Interests in DCENT Classified as Available-for-Sale Investment Securities

Certain of the subordinated beneficial interests we retain in our securitized assets, including Class B and Class C notes issued by DCENT, are classified as available-for-sale investment securities and are carried on our consolidated statement of financial condition at their estimated fair values. Changes in the fair values of these notes are recorded in other comprehensive income within stockholders equity. The fair values of these securities are estimated utilizing discounted cash flow models, where the interest and principal payments are discounted at assumed current market rates for the same or comparable transactions. In performing these valuations, management makes certain assumptions about the credit spreads and liquidity risk premiums that market participants would demand on the same or similar investments given the current market for credit card asset-backed securities.

If management used different assumptions in calculating the weighted average discount rate, the change could have a significant impact on our statement of financial condition and equity. For example, a 10% decrease in the discount rate could have resulted in a $14 million change in the value of the Class B and Class C notes classified as available-for-sale investment securities as of November 30, 2009. However, as described in Accounting Treatment for Off-Balance Sheet Securitizations, pursuant to new FASB guidance related to transfers of financial assets and consolidation, our securitized loans will be consolidated in the Company s financial statements effective December 1, 2009, at which time our certificated retained interests in DCENT will be eliminated in our consolidated financial statements. See Note 4: Investment Securities, Note 6: Credit Card Securitization Activities and Note 24: Fair Value Disclosures to our consolidated financial statements for further discussion about the accounting for our certificated retained interests in DCENT.

Customer Rewards Cost

We offer our customers various reward programs, including the *Cashback Bonus* reward program, pursuant to which we offer certain customers a reward equal to a percentage of their purchase amounts based on the type and volume of the customer s purchases. The liability for customer rewards is included in accrued expenses and other liabilities on our consolidated statements of financial condition. We compute our rewards liability on an individual customer basis and it is accumulated as qualified customers make progress toward earning a reward through their ongoing purchase activity. The liability is adjusted for expected forfeitures of accumulated rewards. We estimate forfeitures based on historical account closure and charge-off experience, actual customer purchase activity and the terms of the rewards programs. We recognize reward costs for both owned loans and securitized loans as a reduction of discount and interchange revenue in the consolidated statements of income.

If management used a different estimate of forfeitures, our consolidated statement of financial condition and results of operations could have differed significantly. For example, a 100 basis point decrease in the estimated forfeiture rate as of November 30, 2009, could have resulted in an increase in accrued expenses and other liabilities of approximately $9 million. The corresponding increase in rewards cost would have been reflected as a decrease in discount and interchange revenue. See Other Income and Note 2: Summary of Significant Accounting Policies to our consolidated financial statements for further details about credit card rewards cost.

Goodwill and Other Nonamortizable Intangible Assets

We recognize goodwill when the purchase price of an acquired business exceeds the fair values of the acquired net assets. In addition, we have recognized certain other nonamortizable intangible assets in our acquisition of the Diners Club business. As required by GAAP, we test goodwill and other nonamortizable intangible assets for impairment annually, or more often if indicators of impairment exist. In evaluating goodwill for impairment, management must estimate the fair value of the business unit(s) to which the goodwill relates. Because market data concerning acquisitions of comparable businesses typically are not readily obtainable, other valuation techniques such as earnings multiples and cash flow models are used in estimating the fair values of these businesses. Similarly, in evaluating the other nonamortizable intangible assets for potential impairment, management estimates their fair values using discounted cash flow models. In applying these techniques, management considers historical results, business forecasts, market and industry conditions and other factors. We may also consult independent valuation experts where needed in applying these valuation techniques. The valuation methodologies we use involve assumptions about business performance, revenue and expense growth, discount rates and other assumptions that are judgmental in nature.

If the assumptions used by management in these valuations are inappropriate, we may be exposed to an impairment loss that, when realized, could have a material impact on our consolidated financial condition and results of operations.

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Income Taxes

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

Changes in the estimate of income taxes can occur due to tax rate changes, interpretations of tax laws, the status and resolution of examinations by the taxing authorities, and newly enacted laws and regulations that impact the relative merits of tax positions taken. When such changes occur, the effect on our consolidated financial condition and results of operations can be significant. See Note 19: Income Taxes to our consolidated financial statements for additional information about income taxes.

Earnings Summary

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

	For the Years Ended November 30,			2009 vs. 2008 increase (decrease)		2008 vs. 2007 increase (decrease)	
	2009	2008	2007	$	%	$	%
Interest income	$ 3,145,080	$ 2,692,563	$ 2,584,402	$ 452,517	17%	$ 108,161	4%
Interest expense	1,251,284	1,288,004	1,223,270	(36,720)	(3%)	64,734	5%
Net interest income	1,893,796	1,404,559	1,361,132	489,237	35%	43,427	3%
Provision for loan losses	2,362,405	1,595,615	733,887	766,790	48%	861,728	117%
Net interest income after provision for loan losses	(468,609)	(191,056)	627,245	(277,553)	(145%)	(818,301)	(130%)
Other income	4,840,595	4,264,458	3,376,682	576,137	14%	887,776	26%
Other expense	2,251,088	2,415,797	2,478,214	(164,709)	(7%)	(62,417)	(3%)
Income from continuing operations before income tax expense	2,120,898	1,657,605	1,525,713	463,293	28%	131,892	9%
Income tax expense	844,713	594,692	561,514	250,021	42%	33,178	6%
Income from continuing operations	$ 1,276,185	$ 1,062,913	$ 964,199	$ 213,272	20%	$ 98,714	10%

Net Interest Income

Net interest income represents the difference between interest income earned on interest-earning assets which we own and the interest expense incurred to finance those assets. Net interest margin represents interest income, net of interest expense, as a percentage of total interest-earning assets on an annualized basis. Our interest-earning assets consist of: (i) loan receivables, (ii) our liquidity reserve which includes amounts on deposit with the Federal Reserve, highly rated certificates of deposit, and triple-A rated government mutual funds, (iii) certain retained interests in securitization transactions included in amounts due from asset securitization, and (iv) investment securities. Interest-earning assets do not include investors interests in securitization transactions that have been transferred to third parties. Similarly, interest income does not include the interest yield on the related loans. Our interest-bearing liabilities consist primarily of deposits, both brokered and direct-to-consumer. Net interest income is influenced by the following:

- The level and composition of interest-earning assets and liabilities, including the percentage of floating rate credit card loan receivables we own and the percentage of floating rate liabilities we owe;

Changes in the interest rate environment, including the levels of interest rates and the relationship between interest rate indices, such as the prime rate and federal funds rate;

Credit performance of our loans, particularly with regard to charge-offs of finance charges which reduce interest income; and

The terms of certificates of deposit upon initial offering, including maturity and interest rate.

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For the Year Ended November 30, 2009 compared to the Year Ended November 30, 2008

For the year ended November 30, 2009, net interest income grew $489.2 million, or 35%, compared to the year ended November 30, 2008. During the same periods, our net interest margin and interest rate spread increased to 4.74% and 3.90%, respectively, up from 4.20% and 3.40%, respectively. A higher average level of on-balance sheet loans was the largest factor driving the increased net interest income, which, along with other factors, is discussed below. The higher average level of on-balance sheet loans at November 30, 2009 compared to November 30, 2008, was due to retaining more loan receivables on-balance sheet throughout 2009 as securitized receivables matured; however, our ending loan receivable balance declined from 2008 to 2009 as we had securitization transactions in the later half of 2009 resulting in a lower level of on-balance sheet loan receivables at year end.

Interest income on credit card loans grew $590.0 million from the year ended November 30, 2008 as a result of retaining more loan receivables on-balance sheet as securitized receivables matured, as well as an increase in the interest yield of 77 basis points. The increase in yield was the result of higher interest rates on standard balances and a substantial reduction in promotional rate balances. This was partially offset by higher interest charge-offs due to the deterioration in the current economic environment as well as a higher average level of on-balance sheet loans.

Interest income on other consumer loans increased $88.8 million from 2008 reflecting growth in both personal and student loans partially offset by a 283 basis point decrease in interest yield. The yield decreased as the proportion of student loans, which bear lower interest rates than personal loans, as a component of total other consumer loans increased.

Interest income on cash and cash equivalents and other assets decreased $247.6 million from 2008 reflecting the unfavorable impact of the lower interest rate environment on our liquidity reserve and amounts due from asset securitization.

The changes in interest expense had a minimal impact on net interest income as lower cost of funds was largely offset by a higher level of deposit funding. Beginning in the second half of 2008, we increased our deposit issuance in order to fund more loan receivables on-balance sheet as a result of securitization maturities. Since that time, benchmark interest rates have declined, also driving down deposit rates. These lower deposit rates contributed to a 59 basis point decline in the cost of deposit funding in 2009 compared to 2008.

For the Year Ended November 30, 2008 compared to the Year Ended November 30, 2007

For the year ended November 30, 2008, net interest income grew $43.4 million, or 3%, compared to the year ended November 30, 2007. During the same periods, our net interest margin and interest rate spread decreased to 4.20% and 3.40%, respectively, down from 4.82% and 3.87%, respectively.

Interest income on credit card loans grew $111.5 million from the year ended November 30, 2007, as a result of retaining more loan receivables on-balance sheet as securitized receivables matured, in addition to a 17 basis point increase in interest yield. This increase in yield was driven by the inclusion of $70.1 million of balance transfer fees in interest income beginning in the third quarter of 2008. This was partially offset by rising interest charge-offs due to the deterioration in the economic environment as well as a higher level of on-balance sheet loans.

Interest income on other consumer loans increased $73.3 million from the year ended November 30, 2007 reflecting growth in both personal and student loans, in addition to a 388 basis point increase in interest yield. The yield increased due to higher rates on newly issued personal loans.

Interest income on cash and cash equivalents and other assets decreased $117.5 million from the year ended November 30, 2007, reflecting the unfavorable impact of the lower interest rate environment on our liquidity reserve and amounts due from asset securitization.

Interest expense increased $64.7 million, or 5%, largely due to our higher average funding levels in 2008, partially offset by a 61 basis point decrease to 4.66% in our cost of funds for the year ended November 30, 2008 as a result of the lower interest rate environment, and the repayment of short-term borrowings due to our former parent company prior to our spin-off.

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The following tables provide further analysis of net interest income, net interest margin and the impact of rate and volume changes for the years ended November 30 (dollars in thousands):

Average Balance Sheet Analysis

	2009			2008			2007		
	Average Balance	Rate	Interest	Average Balance	Rate	Interest	Average Balance	Rate	Interest
Assets									
Interest-earning assets:									
Cash and cash equivalents	$ 8,854,380	0.56%	$ 50,024	$ 8,374,905	2.64%	$ 220,744	$ 4,883,291	5.09%	$ 248,788
Other short-term investments	662,979	0.59%	3,883						
Investment securities	1,581,387	4.34%	68,694	916,307	5.60%	51,345	199,075	5.28%	10,502
Loan receivables:(1)									
Credit card(2)	24,266,782	11.69%	2,835,767	20,566,864	10.92%	2,245,719	19,845,880	10.75%	2,134,188
Other	2,285,792	7.37%	168,517	781,629	10.20%	79,695	101,904	6.32%	6,442
Total loan receivables	26,552,574	11.31%	3,004,284	21,348,493	10.89%	2,325,414	19,947,784	10.73%	2,140,630
Other interest-earning assets	2,338,438	0.78%	18,195	2,770,260	3.43%	95,060	3,237,581	5.70%	184,482
Total interest-earning assets	39,989,758	7.86%	3,145,080	33,409,965	8.06%	2,692,563	28,267,731	9.14%	2,584,402
Allowance for loan losses	(1,808,493)			(887,668)			(658,783)		
Other assets	4,053,270			2,960,496			2,512,889		
Assets from discontinued operations				1,321,595			3,802,047		
Total assets	$ 42,234,535			$ 36,804,388			$ 33,923,884		
Liabilities and Stockholders Equity									
Interest-bearing liabilities:									
Interest-bearing deposits:									
Time deposits(3)	$ 24,748,485	4.52%	1,117,396	$ 21,208,003	5.01%	1,062,741	$ 16,423,343	5.19%	851,988
Money market deposits	4,091,867	1.58%	64,555	4,439,434	3.07%	136,271	3,662,961	5.22%	191,389
Other interest-bearing deposits	283,238	1.81%	5,133	40,337	1.05%	424	36,748	3.26%	1,197
Total interest-bearing deposits	29,123,590	4.08%	1,187,084	25,687,774	4.67%	1,199,436	20,123,052	5.19%	1,044,574
Borrowings:									
Short-term borrowings	837,452	0.30%	2,538	37,660	0.91%	343	1,629,810	5.48%	89,319
Long-term borrowings	1,648,735	3.74%	61,662	1,919,147	4.60%	88,225	1,459,114	6.13%	89,377
Total borrowings	2,486,187	2.58%	64,200	1,956,807	4.53%	88,568	3,088,924	5.79%	178,696
Total interest-bearing liabilities	31,609,777	3.96%	1,251,284	27,644,581	4.66%	1,288,004	23,211,976	5.27%	1,223,270
Other liabilities and stockholders equity Liabilities of discontinued operations				968,406			2,806,564		
Other liabilities and stockholders equity	10,624,758			8,191,401			7,905,344		
Total other liabilities and stockholders equity	10,624,758			9,159,807			10,711,908		
Total liabilities and stockholders equity	$ 42,234,535			$ 36,804,388			$ 33,923,884		
Net interest income			$ 1,893,796			$ 1,404,559			$ 1,361,132

Net interest margin(4)	4.74%	4.20%	4.82%
Interest rate spread(5)	3.90%	3.40%	3.87%

(1) Average balances of loan receivables include non-accruing loans and these loans are therefore included in the yield calculations. If these balances were excluded, there would not be a material impact on the amounts reported above.
(2) Interest income on credit card loans includes $127.5 million and $70.1 million of amortization of balance transfer fees for the years ended November 30, 2009 and 2008, respectively.
(3) Includes the impact of interest rate swap agreements used to change a portion of fixed-rate funding to floating-rate funding.
(4) Net interest margin represents net interest income as a percentage of total interest-earning assets.
(5) Interest rate spread represents the difference between the rate on total interest-earning assets and the rate on total interest-bearing liabilities.

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Rate/Volume Variance Analysis[(1)]

	2009 vs. 2008			2008 vs. 2007		
	Volume	Rate	Total	Volume	Rate	Total
	(in thousands)					
Increase/(decrease) in net interest income due to changes in:						
Interest-earning assets:						
Cash and cash equivalents	$ 11,964	$ (182,684)	$ (170,720)	$ 126,630	$ (154,674)	$ (28,044)
Other short-term investments	3,883		3,883			
Investment securities	30,871	(13,522)	17,349	40,150	693	40,843
Loan receivables:						
Credit card	424,401	165,647	590,048	78,371	33,160	111,531
Other	116,236	(27,414)	88,822	67,089	6,164	73,253
Total loan receivables	540,637	138,233	678,870	145,460	39,324	184,784
Other interest-earning assets	(12,896)	(63,969)	(76,865)	(23,809)	(65,613)	(89,422)
Total interest income	574,459	(121,942)	452,517	288,431	(180,270)	108,161
Interest-bearing liabilities:						
Interest-bearing deposits:						
Time deposits	166,390	(111,735)	54,655	240,645	(29,892)	210,753
Money market deposits	(9,950)	(61,766)	(71,716)	34,890	(90,008)	(55,118)
Other interest-bearing deposits	4,204	505	4,709	107	(880)	(773)
Total interest-bearing deposits	160,644	(172,996)	(12,352)	275,642	(120,780)	154,862
Borrowings:						
Short-term borrowings	2,572	(377)	2,195	(48,003)	(40,973)	(88,976)
Long-term borrowings	(11,433)	(15,130)	(26,563)	24,254	(25,406)	(1,152)
Total borrowings	(8,861)	(15,507)	(24,368)	(23,749)	(66,379)	(90,128)
Total interest expense	151,783	(188,503)	(36,720)	251,893	(187,159)	64,734
Net interest income	$ 422,666	$ 66,571	$ 489,237	$ 36,227	$ 7,200	$ 43,427

(1) The rate/volume variance for each category has been allocated on a consistent basis between rate and volume variances based on the percentage of the rate or volume variance to the sum of the two absolute variances.

Loan Quality

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

	November 30, 2009	November 30, 2008	November 30, 2007	November 30, 2006	November 30, 2005
Loans held for sale	$	$	$	$ 1,056,380	$ 2,437,060
Loan portfolio:					
Credit card loans:					
Discover Card[(1)]	19,826,153	23,348,134	20,345,787	19,582,675	18,000,767
Discover Business Card	404,149	466,173	234,136	59,088	
Total credit card loans	20,230,302	23,814,307	20,579,923	18,641,763	18,000,767

Other consumer loans:					
Personal loans	1,394,379	1,028,093	165,529	24,968	52,837
Student loans	1,932,266	299,929	12,820	155	242
Other	68,137	74,282	72,845	66,978	120,400
Total other consumer loans	3,394,782	1,402,304	251,194	92,101	173,479
Total loan portfolio	23,625,084	25,216,611	20,831,117	19,733,864	18,174,246
Total loan receivables	23,625,084	25,216,611	20,831,117	20,790,244	20,611,306
Allowance for loan losses	(1,757,899)	(1,374,585)	(759,925)	(703,917)	(795,722)
Net loan receivables	$ 21,867,185	$ 23,842,026	$ 20,071,192	$ 20,086,327	$ 19,815,584

(1) Amounts include $9.9 billion and $14.8 billion of the Company s seller s interest in credit card securitizations at November 30, 2009 and 2008, respectively. See Note 6: Credit Card Securitization Activities to our consolidated financial statements for further information.

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Provision and Allowance for Loan Losses

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

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

In calculating the allowance for loan losses, we estimate probable losses separately for segments of the loan portfolio that have similar risk characteristics. For our credit card loans, we use a migration analysis to determine the likelihood that a loan receivable will progress through various stages of delinquency to charge off. An estimated charge-off ratio is then applied to each delinquency category to derive an estimated reserve rate. To determine if any adjustments should be made to the reserve rate derived from the migration analysis, we consider current economic trends as well as the difference between actual charge-offs and what was estimated to be charged off in recent periods. For our other consumer loans, we consider historical and forecasted losses in estimating the related allowance for loan losses.

For the year ended November 30, 2009, the provision for loan losses increased $766.8 million, or 48%, compared to the year ended November 30, 2008, reflecting higher net charge-offs and an increase in the level of allowance for loan losses. Higher net charge-offs are a result of the deterioration in the current economic environment, and are discussed further in Net Charge-offs and Delinquencies below. At November 30, 2009, the allowance for loan losses was $1.8 billion, an increase of $383.3 million from November 30, 2008. This increase reflects a reserve addition related to a 199 basis point increase to the reserve rate, partially offset by a $1.6 billion decline in on-balance sheet loans at November 30, 2009.

For the year ended November 30, 2008, the provision for loan losses increased $861.7 million, or 117%, compared to the year ended November 30, 2007, reflecting an increase in the level of allowance for loan losses and higher net charge-offs. In the year ended November 30, 2008, we added $614.7 million to the allowance for loan losses to bring the total allowance to $1.4 billion, an increase of 81% over November 30, 2007. This increase in the allowance reflects an increase in the loan loss reserve rate due to rising delinquency and charge-off rates and loan growth, particularly in the fourth quarter of 2008 as we retained more loan receivables from maturing securitizations on our balance sheet in response to the inability to re-securitize the receivables as a result of the disruption in the securitization markets at that time.

The following table provides changes in the Company s allowance for loan losses for the years presented (dollars in thousands):

	For the Years Ended November 30,				
	2009	**2008**	**2007**	**2006**	**2005**
Balance at beginning of year	$ 1,374,585	$ 759,925	$ 703,917	$ 795,722	$ 910,261
Additions:					

Provision for loan losses	2,362,405	1,595,615	733,887	606,765	816,197
Deductions:					
Charge-offs	(2,165,653)	(1,147,241)	(839,092)	(852,636)	(1,076,179)
Recoveries	186,562	166,286	161,213	154,066	145,642
Net charge-offs	(1,979,091)	(980,955)	(677,879)	(698,570)	(930,537)
Translation adjustments and other					(199)
Balance at end of year	$ 1,757,899	$ 1,374,585	$ 759,925	$ 703,917	$ 795,722

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The following table provides changes in the Company s allowance for credit card loan losses for the years presented (dollars in thousands):

	For the Years Ended November 30,				
	2009	2008	2007	2006	2005
Balance at beginning of year	$ 1,317,811	$ 750,786	$ 701,162	$ 790,346	$ 899,969
Additions:					
Provision for loan losses	2,240,232	1,540,507	726,632	606,455	812,410
Deductions:					
Charge-offs	(2,096,573)	(1,139,176)	(837,210)	(848,645)	(1,066,785)
Recoveries	185,616	165,694	160,202	153,006	144,752
Net charge-offs	(1,910,957)	(973,482)	(677,008)	(695,639)	(922,033)
Balance at end of year	$ 1,647,086	$ 1,317,811	$ 750,786	$ 701,162	$ 790,346

The following table provides changes in the Company s allowance for other consumer loan losses for the years presented (dollars in thousands):

	For the Years Ended November 30,				
	2009	2008	2007	2006	2005
Balance at beginning of year	$ 56,774	$ 9,139	$ 2,755	$ 5,376	$ 10,292
Additions:					
Provision for loan losses	122,173	55,108	7,255	310	3,787
Deductions:					
Charge-offs	(69,080)	(8,065)	(1,882)	(3,991)	(9,394)
Recoveries	946	592	1,011	1,060	890
Net charge-offs	(68,134)	(7,473)	(871)	(2,931)	(8,504)
Translation adjustments and other					(199)
Balance at end of year	$ 110,813	$ 56,774	$ 9,139	$ 2,755	$ 5,376

Net Charge-offs

Our net charge-offs include the principal amount of losses charged off less principal recoveries and exclude charged-off interest and fees, recoveries of interest and fees and fraud losses. Charged-off and recovered interest and fees are recorded in interest and loan fee income for loan receivables and in securitization income for securitized loans 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, except in the case of customer bankruptcies and probate accounts. 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 contractual time frame. The net charge-off rate is calculated by dividing net charge-offs for the period by the average loan receivables for the period.

The following table presents amounts and rates of net charge-offs of loan receivables (dollars in thousands):

	For the Years Ended November 30,				
	2009	2008	2007	2006	2005

	$	%	$	%	$	%	$	%	$	%
Credit card loans	$ 1,910,957	7.87%	$ 973,482	4.73%	$ 677,008	3.41%	$ 695,639	3.64%	$ 922,033	4.95%
Other consumer loans	68,134	2.98%	7,473	0.96%	871	0.85%	2,931	2.22%	8,504	3.69%
Total net charge-offs	$ 1,979,091	7.45%	$ 980,955	4.59%	$ 677,879	3.40%	$ 698,570	3.63%	$ 930,537	4.93%

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The net charge-off rate on our loan receivables increased 286 basis points and 119 basis points for the years ended November 30, 2009 and 2008, respectively, compared to November 30, 2008 and 2007. The net charge-off rate has steadily increased since the fourth quarter of 2008, reflecting the weakening economic environment as a result of rising unemployment, an increase in bankruptcy-related charge-offs and the decrease in the availability of consumer credit. Additionally, personal loans, which are included in other consumer loans, grew significantly in 2008 and into 2009, have seasoned and have started to experience charge-offs.

Delinquencies

Delinquencies are an indicator of credit quality at any point in time. Loan balances are considered delinquent when contractual payments on the loan become 30 days past due. Loan receivables are placed on non-accrual status upon receipt of notification of the bankruptcy or death of a customer, suspected fraudulent activity on an account, as part of certain collection management processes, and other instances in which management feels collectability is not assured. In some cases of suspected fraudulent activity, loan receivables may resume accruing interest upon completion of the fraud investigation.

The following table presents the amounts and delinquency rates of loan receivables over 30 days past due, loan receivables over 90 days delinquent and accruing interest and loan receivables that are not accruing interest, regardless of delinquency (dollars in thousands):

	At November 30,									
	2009		2008		2007		2006		2005	
	$	%	$	%	$	%	$	%	$	%
Loans over 30 days delinquent	$ 1,161,497	4.92%	$ 1,096,627	4.35%	$ 679,306	3.26%	$ 633,150	3.05%	$ 756,198	3.67%
Loans over 90 days delinquent and accruing interest	$ 522,190	2.21%	$ 444,324	1.76%	$ 271,227	1.30%	$ 244,675	1.18%	$ 263,439	1.28%
Loans not accruing interest	$ 190,086	0.80%	$ 173,123	0.69%	$ 102,286	0.49%	$ 110,625	0.53%	$ 215,671	1.05%

The delinquency rates of loans over 30 days delinquent and loans over 90 days delinquent and accruing interest increased 57 basis points and 45 basis points, respectively at November 30, 2009, as compared to November 30. 2008. The increase in both measures reflected the impact of the weaker economic environment on our customers ability to pay their loan balances. Delinquency rates normally rise as charge-offs rise, however, since the third quarter 2008, we have been experiencing a pattern of charge-offs rising faster than delinquencies. This pattern is the result of having a higher proportion of balances move from delinquent status to charge-off than in historical periods. The movement from delinquent status to charge-off has increased as more customers are unable to become current on their past-due accounts and as more customers declare bankruptcy. Loan receivables not accruing interest at November 30, 2009 increased 11 basis points to 0.80%, as compared to November 30, 2008, as a result of an increase in bankruptcy notifications.

The delinquency rates of loans over 30 days delinquent and loans over 90 days delinquent and accruing interest increased 109 basis points and 46 basis points, respectively, at November 30, 2008, as compared to November 30, 2007. This increase in both measures reflected of the weaker economic environment on our customers ability to pay their loan balances. Loan receivables not accruing interest at November 30, 2008 increased 20 basis points to 0.69%, as compared to November 30, 2007, as a result of an increase in bankruptcy notifications.

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Maturities and Sensitivities of Loan Receivables to Changes in Interest Rates

Our loan receivables had the following maturity distribution[1] at November 30, 2009 (dollars in thousands):

	Due One Year or Less	Due After One Year Through Five Years	Due After Five Years	Total
Credit card loans	$ 4,854,184	$ 10,235,498	$ 5,140,620	$ 20,230,302
Other consumer loans	2,174	869,912	2,522,696	3,394,782
Total loan receivables	$ 4,856,358	$ 11,105,410	$ 7,663,316	$ 23,625,084

(1) Because of the uncertainty regarding loan repayment patterns, the above amounts have been calculated using contractually required minimum payments. Historically, actual loan repayments have been higher than such minimum payments, and therefore, the above amounts may not necessarily be indicative of our actual loan repayments.

At November 30, 2009, approximately $9.9 billion of our loan receivables due after one year had interest rates tied to an index and approximately $8.9 billion were fixed rate loans.

Other Income

The principal component of other income is securitization income. The following table presents the components of other income for the periods presented (dollars in thousands):

	For the Years Ended November 30,			2009 vs. 2008 increase (decrease)		2008 vs. 2007 increase (decrease)	
	2009	2008	2007	$	%	$	%
Securitization income	$ 1,879,304	$ 2,429,158	$ 2,323,623	$ (549,854)	(23%)	$ 105,535	5%
Loan fee income	247,267	262,576	338,053	(15,309)	(6%)	(75,477)	(22%)
Discount and interchange revenue[1]	222,835	187,657	241,070	35,178	19%	(53,413)	(22%)
Fee products	295,066	249,805	214,572	45,261	18%	35,233	16%
Merchant fees	44,248	67,027	92,518	(22,779)	(34%)	(25,491)	(28%)
Transaction processing revenue	125,201	115,914	99,653	9,287	8%	16,261	16%
Loss on investment securities	(3,826)	(50,294)	(11,409)	46,468	92%	(38,885)	NM
Antitrust litigation settlement.	1,891,698	863,634		1,028,064	119%	863,634	100%
Other income	138,802	138,981	78,602	(179)	0%	60,379	77%
Total other income	$ 4,840,595	$ 4,264,458	$ 3,376,682	$ 576,137	14%	$ 887,776	26%

(1) Net of rewards, including *Cashback Bonus* rewards, of $669.5 million, $709.7 million and $721.9 million for the years ended November 30, 2009, 2008 and 2007, respectively.

Total other income increased $576.1 million, or 14%, for the year ended November 30, 2009, as compared to the year ended November 30, 2008, primarily as a result of $1.0 billion of higher income related to the Visa and MasterCard antitrust litigation settlement, partially offset by lower securitization income. For the year ended November 30, 2008, total other income increased $887.8 million, or 26%, as compared to November 30, 2007, primarily as a result of an $862.5 million payment from MasterCard for its portion of the Visa and MasterCard antitrust litigation settlement and higher securitization income, partially offset by a decline in loan fee income. These key drivers as well as other factors are discussed in more detail below.

Securitization Income

Through November 30, 2009, the issuance of asset-backed securities to investors, referred to as securitization, has the effect of removing the owned loan receivables from our consolidated statements of financial condition. Securitization income is a significant source of our income and is derived through the securitization and continued servicing of a portion of the credit card loan receivables we originate. Also, portions of net interest income, provision for loan losses and certain components of other income related to the securitized loans against which beneficial interests have been issued are no longer reported in our statements of income; however, they remain significant factors in determining securitization income we receive on our residual interests in those transactions. We allocate the cash flows derived from interest and loan fee revenue and, in recent years, merchant discount and interchange revenue earned on securitized loans (see

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further discussion of merchant discount and interchange revenue below) to investors in securitizations. These cash flows are used to pay investors in the transactions a contractual rate of return on their investment, to reimburse investors for losses of principal resulting from charged-off loans, net of recoveries, and to pay us a contractual fee for servicing the securitized loans. Any excess cash flows, referred to as excess spread, are paid to us. Both servicing fees and excess spread are recorded in securitization income. Securitization income also includes the net revaluation of the interest-only strip receivable and certain other retained interests, reflecting adjustments to the fair values that result from changes in the level of securitized loans and assumptions used to value the retained interests.

Beginning December 1, 2009, our results of operations will no longer reflect securitization income, but will instead report interest income, net charge-offs and certain other income associated with all securitized loan receivables and interest expense associated with debt issued from the trusts to third-party investors in the same line items in our results of operations as non-securitized credit card loan receivables and corporate debt. Additionally, we will no longer record initial gains on new securitization activity since securitized credit card loans will no longer receive sale accounting treatment, nor will there be any gains or losses on the revaluation of the interest-only strip receivable as that asset is not recognizable in a transaction accounted for as a secured borrowing and, accordingly, will be derecognized on December 1, 2009. For more information, see Accounting Treatment for Off-Balance Sheet Securitizations.

The table below presents the components of securitization income (dollars in thousands):

	For the Years Ended November 30,			2009 vs. 2008 increase (decrease)		2008 vs. 2007 increase (decrease)	
	2009	**2008**	**2007**	**$**	**%**	**$**	**%**
Excess spread	$ 1,570,005	$ 2,017,146	$ 1,753,844	$ (447,141)	(22%)	$ 263,302	15%
Servicing fees on securitized loans	492,095	553,398	538,409	(61,303)	(11%)	14,989	3%
Net revaluation of retained interests(1)	(160,087)	(119,324)	51,346	(40,763)	(34%)	(170,670)	NM
Other (principally transaction costs)	(22,709)	(22,062)	(19,976)	(647)	(3%)	(2,086)	(10%)
Total securitization income	$ 1,879,304	$ 2,429,158	$ 2,323,623	$ (549,854)	(23%)	$ 105,535	5%

(1) Net of issuance discounts, as applicable.

Securitization income is significantly influenced by the level of average securitized loans. Average securitized loans of $24.6 billion for the year ended November 30, 2009, was significantly lower than the $27.7 billion and $27.0 billion average levels of securitized loans at November 30, 2008 and 2007, respectively, as a result of the disruption in the credit card asset-backed securitization markets beginning in the fourth quarter of 2008 and continuing into 2009.

For the year ended November 30, 2009, securitization income decreased $549.9 million, or 23%, as compared to the year ended November 30, 2008. The decrease is primarily attributable to lower excess spread on securitized loans along with lower servicing fees earned and a decrease in the net revaluation of retained interests. In 2008, securitization income increased $105.5 million, or 5%, as compared to 2007 primarily reflecting higher excess spread on securitized loans offset in part by a decrease in the net revaluation of retained interests. These variances, as well as other factors, are described in more detail in the tables and discussion below.

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Excess spread. The following table provides the components of excess spread (dollars in thousands):

	For the Years Ended November 30, 2009	2008	2007	2009 vs. 2008 increase (decrease) $	%	2008 vs. 2007 increase (decrease) $	%
Interest income on securitized loans	$ 3,315,992	$ 3,853,266	$ 3,794,272	$ (537,274)	(14%)	$ 58,994	2%
Interest paid to investors in asset-backed securities	(397,136)	(1,068,915)	(1,517,858)	671,779	63%	448,943	30%
Net interest income	2,918,856	2,784,351	2,276,414	134,505	5%	507,937	22%
Other fee revenue on securitized loans(1)	1,139,180	1,259,182	1,135,347	(120,002)	(10%)	123,835	11%
Net charge-offs on securitized loans	(1,995,936)	(1,472,989)	(1,119,508)	(522,947)	(36%)	(353,481)	(32%)
Net revenues on securitized loans	2,062,100	2,570,544	2,292,253	(508,444)	(20%)	278,291	12%
Servicing fees on securitized loans	(492,095)	(553,398)	(538,409)	61,303	11%	(14,989)	(3%)
Excess spread	$ 1,570,005	$ 2,017,146	$ 1,753,844	$ (447,141)	(22%)	$ 263,302	15%

(1) Other fee income includes discount and interchange revenue, loan fee income and fee products revenue.

For the year ended November 30, 2009, excess spread on securitized loans decreased $447.1 million, or 22%, as compared to the year ended November 30, 2008. The decrease was mainly due to higher net charge-offs and lower other fee revenue on securitized loans partially offset by higher net interest income. Higher net charge-offs were reflective of the current economic environment. Lower other fee revenue was attributable to a lower level of securitized loans. The increase in net interest income was due to a decrease in the interest paid to investors reflective of the impact of a lower average LIBOR on floating rate investor interests, partially offset by lower interest income earned on securitized loans as a result of the lower level of securitized loans.

For the year ended November 30, 2008, excess spread on securitized loans increased $263.3 million, or 15%, as compared to the year ended November 30, 2007. The increase was attributable to higher net interest income and higher other fee revenue on securitized loans offset in part by higher net charge-offs. The increase in net interest income related largely to a decrease in interest paid to investors reflective of the impact of a lower average LIBOR on floating rate investor interests, offset in part by wider spreads paid to investors on new transactions. Higher other fee revenue was attributable to the higher level of outstanding securitized loans receiving discount and interchange revenue. The higher net charge-offs were reflective of the weakening economic and credit environment.

Servicing fees on securitized loans. Servicing fees are paid to the Company for servicing the transferred loan receivables in accordance with contractual requirements and are largely dependent on the level of securitized loans. We are paid a servicing fee from the cash flows generated by the securitized loans, which include interest income and loan fee income and, effective with trust actions taken in July 2009, discount and interchange revenue for all securitized loans. In 2009, servicing fees decreased as compared to 2008 by $61.3 million, or 11%, as a result of a lower level of securitized loans, while servicing fees increased in 2008 as compared to 2007 by $15.0 million, or 3%, due to a higher level of securitized loans.

Net revaluation of retained interests. The components of net revaluation of retained interests are summarized in the table below (dollars in thousands):

	For the Years Ended November 30, 2009	2008	2007	2009 vs. 2008 increase (decrease) $	2008 vs. 2007 increase (decrease) $
Initial gain on new securitization transactions(1)	$ 16,707	$ 71,872	$ 122,949	$ (55,165)	$ (51,077)
Revaluation of retained interests	(176,794)	(191,196)	(71,603)	14,402	(119,593)

Net revaluation of retained interests	$ (160,087)	$ (119,324)	$ 51,346	$ (40,763)	$ (170,670)

(1) Net of issuance discounts, as applicable.

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The net revaluation of retained interests for the year ended November 30, 2009 decreased $40.8 million, as compared to the year ended November 30, 2008. The decrease included $55.2 million lower initial gains on a lower level of securitization activity ($3.6 billion of new third-party securitization transactions for the year ended November 30, 2009 as compared to $5.6 billion of new third-party securitization transactions for the year ended November 30, 2008). The unfavorable revaluation of retained interests of $176.8 million for the year ended November 30, 2009 was largely related to changes in the assumptions used to value the interest-only strip receivable as compared to the previous period, including lower projected excess spread. The lower projected excess spread reflected higher projected charge-offs partially offset by a higher expected net interest spread reflective of repricing actions taken during 2009. This was partially offset by a gain in our cash collateral account as compared to a loss in the prior year, reflecting a decrease in the remaining life of our cash collateral accounts.

The net revaluation of retained interests for the year ended November 30, 2008 decreased $170.7 million, as compared to the year ended November 30, 2007. The decrease included $51.1 million lower initial gains on a lower level of securitization activity ($5.6 billion of new third-party securitization transactions for the year ended November 30, 2008 as compared to $8.5 billion of new third-party securitization transactions for the year ended November 30, 2007) and lower projected excess spread on new securitizations as a result of higher charge-offs. The unfavorable revaluation of retained interests of $191.2 million for the year ended November 30, 2008 largely related to unfavorable changes in assumptions used to value the interest-only strip receivable as compared to the previous period end, including lower projected excess spread. The lower projected excess spread reflected higher projected charge-offs, higher interest rate projections and widening spreads on new securitizations as a result of trends in the securitization markets.

Loan Fee Income

Loan fee income consists primarily of fees on credit card loans and includes late, over-limit, cash advance, pay-by-phone and other miscellaneous fees, although, beginning in February 2010, we will no longer charge over-limit or pay-by-phone fees as a result of changes made in connection with the CARD Act. Loan fee income decreased $15.3 million, or 6%, for the year ended November 30, 2009, as compared to November 30, 2008 as a result of deferrals of balance transfer fees and higher charge-offs and adjustments of loan fees, partially offset by an increase in income from late fees. Loan fee income decreased $75.5 million, or 22%, for the year ended November 30, 2008, as compared to November 30, 2007, as a result of deferrals of balance transfer fees. Beginning in mid 2008, balance transfer fees, historically accounted for in loan fee income, were deferred and accreted into interest income over the life of the loan.

Discount and Interchange Revenue

Discount and interchange revenue includes discount revenue and acquirer interchange net of interchange paid to third-party issuers in the United States. We earn discount revenue from fees charged to merchants with whom we have entered into card acceptance agreements for processing credit card purchase transactions. We earn acquirer interchange revenue from merchant acquirers on all Discover Network card transactions made by credit card customers at merchants with whom merchant acquirers have entered into card acceptance agreements for processing credit card purchase transactions. We incur an interchange cost to card issuing entities that have entered into contractual arrangements to issue cards on the Discover Network. This cost is contractually established and is based on the card issuing organization s transaction volume and is reported as a reduction to discount and interchange revenue. We offer our customers various reward programs, including the *Cashback Bonus* reward program, pursuant to which we pay certain customers a percentage of their purchase amounts based on the type and volume of the customer s purchases. Reward costs are recorded as a reduction to discount and interchange revenue.

Discount and interchange revenue increased $35.2 million, or 19%, for the year ended November 30, 2009, compared to November 30, 2008, due to lower customer rewards costs, partially offset by lower revenues earned on a lower level of owned loans. Lower customer rewards costs were due to a decline in sales volume, partially offset by adjustments made in the third quarter of 2008 to the rewards liability for an increase in expected forfeitures of accumulated rewards.

Discount and interchange revenue decreased $53.4 million, or 22% for the year ended November 30, 2008, compared to November 30, 2007, due to higher allocations to securitized loans, partially offset by lower customer rewards costs related to revised forfeiture assumptions and higher discount and interchange revenue. The increase in allocations to securitized loans was due to a higher level of average outstanding securitized loans receiving such allocations in the 2008 compared to 2007.

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Fee Products

We earn revenue related to fees received for selling ancillary products and services including debt deferment/debt cancellation and identity theft protection services to customers. The amount of revenue recorded is generally based on either a percentage of a customer s outstanding balance or a flat fee and is recognized over the agreement or contract period as earned. Fee products income increased $45.3 million, or 18%, and $35.2 million, or 16%, for the years ended November 30, 2009 and 2008, respectively, as compared to the years ended November 30, 2008 and 2007, primarily related to an increase in the number of customers that purchased these products and services as well as higher balances upon which the fees are based.

Merchant Fees

To broaden merchant acceptance of Discover Network cards, we began outsourcing our acquisition and servicing of small and mid-sized merchants to merchant acquiring organizations in late 2006. In addition, we have sold small and mid-size merchant portfolios to third-party acquirers to facilitate integrated servicing and to reduce costs. As we move away from direct merchant relationships, our merchant fee income and related costs will decline. The lower cost per transaction is generally expected to be offset by increased volume due to broader acceptance. Gains on the sale of merchant acquiring portfolios are reflected in other income as earned.

Merchant fees consist primarily of fees charged to merchants for various services including manual authorization of transactions and delivery of hardcopy statements. For the years ended November 30, 2009 and 2008, merchant fees decreased $22.8 million, or 34%, and $25.5 million, or 28%, as compared to the years November 30, 2008 and 2007, respectively. The decrease in both periods is due to increased outsourcing to merchant acquirers. As merchant acquiring portfolios are sold to third-party merchant acquirers, this revenue will decrease along with associated costs.

Transaction Processing Revenue

Transaction processing revenue represents switch fees charged to financial institutions and merchants for processing ATM, debit and point-of-sale transactions over the PULSE Network, as well as various participation and membership fees. Switch fees are charged on a per transaction basis. Transaction processing revenue increased $9.3 million, or 8%, and $16.3 million, or 16%, for the years ended November 30, 2009 and 2008, respectively, as compared to the years ended November 30, 2008 and 2007, primarily due to increased volumes partially offset by pricing incentives offered to financial institutions, which are accounted for as an offset to revenue.

Loss on Investment Securities

Loss on investment securities includes realized gains and losses on the sale of investments as well as any write-downs of investment securities to fair value when the decline in fair value is considered other than temporary. During the year ended November 30, 2009, we recorded an $8.2 million write-down of the asset-backed commercial paper notes of Golden Key U.S. LLC, which invested in mortgage-backed securities, partially offset by $5.4 million of income related to other asset-backed securities held as available-for-sale investment securities that were sold during the year. For the years ended November 30, 2009, 2008 and 2007, we recorded other-than-temporary impairment in our investment in the asset-backed commercial paper notes of Golden Key U.S. LLC, of $8.2 million, $49.1 million and $11.4 million, respectively. The loss on investment securities for 2008 and 2007 was mainly comprised of the other-than-temporary impairment recorded for these notes. In the fourth quarter of 2009, we recorded an unrealized gain of $7.5 million related to these notes through other comprehensive income. See additional information on other-than-temporary-impairments recorded in our consolidated statements of income in Note 4: Investment Securities.

Antitrust Litigation Settlement

Amounts received in conjunction with the Visa and MasterCard antitrust litigation settlement, including related interest, are recorded in this line item when earned. We received $1.9 billion in 2009 from Visa as payment for its portion of the settlement and a total of $4.2 million in related interest income. In 2008, we received $0.9 billion from MasterCard as payment for its portion of the settlement. See additional information in Liquidity and Capital Resources Special Dividend and Settlement of Visa and MasterCard Antitrust Litigation. We entered into an agreement with Morgan Stanley at the time of our spin-off to give us sole control over the investigation, prosecution and resolution of the litigation and to determine how proceeds from the litigation would be shared. The matter is a subject of litigation between the parties. See Legal Proceedings for additional background and recent developments related to this litigation.

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Other Income

Other income includes revenues from the sale of merchant portfolios to third-party acquirers, royalty revenues earned by Diners Club, revenues from the referral of declined applications to certain third-party issuers on the Discover Network, unrealized gains and losses related to derivative contracts and other miscellaneous revenue items. Other income was relatively flat for the year ended November 30, 2009 compared to November 30, 2008 despite the inclusion of Diners Club revenue for a full year, which was largely offset by lower gains on sales of merchant portfolios and lower revenues from the referral of declined applications to third-party issuers. Other income increased $60.4 million in 2008, primarily due to the inclusion of Diners Club revenue and reporting an unrealized gain on interest rate swap agreements for the year ended November 30, 2008 compared to an unrealized loss for the year ended November 30, 2007. These increases were partially offset by lower gains from sales of merchant portfolios.

Other Expense

The following table represents the components of other expense for the periods presented (dollars in thousands):

	For the Years Ended November 30,			2009 vs. 2008 increase (decrease)		2008 vs. 2007 increase (decrease)	
	2009	2008	2007	$	%	$	%
Employee compensation and benefits	$ 827,683	$ 845,392	$ 850,065	$ (17,709)	(2%)	$ (4,673)	(1%)
Marketing and business development	406,020	530,901	576,263	(124,881)	(24%)	(45,362)	(8%)
Information processing and communications	289,209	315,943	330,053	(26,734)	(8%)	(14,110)	(4%)
Professional fees	321,329	349,484	361,409	(28,155)	(8%)	(11,925)	(3%)
Premises and equipment	73,014	80,394	79,442	(7,380)	(9%)	952	1%
Other expense	333,833	293,683	280,982	40,150	14%	12,701	5%
Total other expense	$ 2,251,088	$ 2,415,797	$ 2,478,214	$ (164,709)	(7%)	$ (62,417)	(3%)

Total other expense decreased $164.7 million, or 7%, for the year ended November 30, 2009, as compared to November 30, 2008. Expenses were lower overall reflecting the impact of cost containment initiatives. Marketing fees decreased $124.9 million, or 24%, mainly due to a reduction in new account acquisition, which included reductions in postage, supplies and credit bureau fees. Other expense increased $40.2 million, or 14%, due to the inclusion of a full year of Diners Club expenses compared to only six months in 2008, a one-time expense related to a reduction in force, other expenses related to the Morgan Stanley special dividend, increased costs associated with the global expansion initiative and a charge related to a facility closure, partially offset by lower fraud costs.

Total other expense decreased $62.4 million, or 3%, for the year ended November 30, 2008, as compared to November 30, 2007. The decrease was primarily driven by lower marketing expenditures, lower information processing and communications and lower professional fees, partially offset by the inclusion of Diners Club expenses. Marketing fees decreased $45.4 million, or 8% in the same period due to lower direct marketing activity partially offset by increased internet and television advertising. Information processing and communications fees declined due to lower depreciation expense as certain assets became fully depreciated in 2008. Professional fees decreased $11.9 million, or 3%, primarily due to lower legal fees relating to lower general, regulatory and routine advisory legal fees partially offset by an increase in collection fees. Employee compensation and benefits expense decreased due to a pension credit as a result of the announcement of the freezing of benefit accruals under the pension plans in 2008 partially offset by higher compensation costs.

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Income Tax Expense

	For the Years Ended November 30,		
	2009	2008	2007
U.S. federal statutory income tax rate	35.0%	35.0%	35.0%
U.S. state and local income taxes, net of U.S. federal income tax benefits	4.1	2.5	2.2
Federal examinations and settlements			
State examinations and settlements		(0.9)	(0.1)
Valuation allowance capital loss	1.1		
Non-deductible spin-off costs			0.2
Non-deductible compensation	0.4		
Other	(0.8)	(0.7)	(0.5)
Effective income tax rate	39.8%	35.9%	36.8%

Income tax expense increased $250.0 million, or 42%, for the year ended November 30, 2009 as compared to the year ended November 30, 2008, reflecting an increase in pretax income and a higher effective tax rate. The effective tax rate increased 3.9% for the year ended November 30, 2009 from 35.9% for the year ended November 30, 2008 as a result of (i) a higher effective state tax rate due to estimated taxes payable in additional states, (ii) a valuation allowance of $23.7 million which was recorded in 2009 against deferred tax assets largely related to our assessment of the likelihood that the tax benefit of capital losses related to the sale of the Goldfish business in 2008 is no longer realizable; and (iii) tax expense of $9.4 million recorded in 2009 related to non-deductible stock-based compensation.

Income tax expense increased $33.2 million, or 6%, for the year ended November 30, 2008 as compared to the year ended November 30, 2007, reflecting an increase in pretax income partially offset by a lower effective tax rate. The effective tax rate decreased 0.9% for the year ended November 30, 2008 from 36.8% for the year ended November 30, 2007 as a result of the settlement of certain state examination issues, which resulted in a tax benefit during 2008.

Liquidity and Capital Resources

Funding and Liquidity

We seek to maintain diversified funding sources and a strong liquidity profile in order to fund our business and service our maturing obligations. In addition, we seek to achieve an appropriate maturity profile, to utilize a cost-effective mix of both long-term and short-term funding sources and to ensure the composition of our investor base provides appropriate diversification. Our primary funding sources include deposits, sourced directly or through brokers, term asset-backed securitizations, asset-backed conduit financing and long-term borrowings.

During 2009, we raised approximately $15.4 billion through new issuances and renewals of existing deposits, the majority of which were sourced through our direct-to-consumer deposit channel. We also successfully completed several capital market transactions including $3.6 billion of asset-backed securitizations that were eligible for funding through the TALF program and asset-backed conduit financing, an offering of $400 million in principal amount of senior unsecured notes, an offering of $700 million in principal amount of subordinated notes of Discover Bank and a common stock offering resulting in approximately $534 million in net proceeds to us.

Funding Sources

Deposits. We offer deposit products, including certificates of deposit, money market accounts, online savings accounts and Individual Retirement Account (IRA) certificates of deposits, to customers through two channels: (i) directly through direct mail, internet origination and affinity relationships (direct-to-consumer deposits); and (ii) indirectly through contractual arrangements with brokerage firms (brokered deposits).

During 2009, we significantly expanded our direct-to-consumer program with such deposits increasing $6.4 billion, or 103%, to $12.6 billion at the end of 2009, and we expect to continue to grow our use of this deposit channel in 2010.

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The direct-to-consumer channel provides us with the ability to renew certificates of deposit and to cross-sell deposit products to our credit card customers. During the same period, we decreased our brokered deposits by $2.8 billion, or 13%, to $19.5 billion at November 30, 2009. Maturities of our certificates of deposit range from one month to fifteen years, with a weighted average maturity of 26 months at November 30, 2009.

The following table summarizes deposits by product and maturities as of November 30, 2009 (dollars in thousands):

	Total	Three Months or Less	Over Three Months Through Six Months	Over Six Months Through Twelve Months	Over Twelve Months
Certificates of deposit in amounts less than $100,000[1]	$ 22,587,898	$ 1,424,998	$ 1,992,770	$ 3,796,138	$ 15,373,992
Certificates of deposit in amounts of $100,000[1] or greater	4,047,949	390,605	392,870	1,372,232	1,892,242
Savings deposits, including money market deposit accounts	5,392,659	5,392,659			
Total interest-bearing deposits	$ 32,028,506	$ 7,208,262	$ 2,385,640	$ 5,168,370	$ 17,266,234

(1) Represents the basic insurance amount covered by the FDIC although, effective May 20, 2009, a higher amount of $250,000 of basic insurance per depositor is in effect through December 31, 2013. As of November 30, 2009, uninsured deposits represented approximately 2.0% of total interest-bearing deposits.

Securitization Financing. Historically, we have used the securitization of credit card receivables as one of our largest sources of funding, including both the public securitization market and the privately placed asset-backed conduit financing market.

For much of 2008 and 2009, market events and capital market disruptions had made the securitization market unavailable at volumes and pricing that would be attractive to us. In November 2008, the Federal Reserve announced the launch of the Term Asset-Backed Securities Loan Facility, or TALF, in an effort to facilitate the issuance of asset-backed securities by offering financing on relatively favorable terms. The TALF program currently extends through March 31, 2010. DCENT issued its first TALF-eligible transaction on July 14, 2009 for $1.5 billion with a three year term. DCENT issued a second TALF-eligible transaction on September 11, 2009 for $1.3 billion with a three year term.

We have capacity to issue up to $9.6 billion in triple-A rated asset-backed securities from our securitization trusts, the same amount of which is available for issuance on or before March 31, 2010 through the TALF program. The triple-A rating of DCENT Class A Notes issued to date has been based, in part, on an FDIC rule which provides that the FDIC will not seek to reclaim or recover assets transferred in connection with a securitization, or recharacterize them as assets of the insured depository institution, provided such transfer meets the conditions for sale accounting treatment under GAAP. Pursuant to FASB guidance related to transfers of financial assets and consolidations, effective December 1, 2009, the transfer of assets made to the Discover Card Master Trust I (DCMT) and DCENT will no longer qualify for sale accounting treatment. Consequently, there has been uncertainty in the securitization market as to how the FDIC will treat assets transferred into securitization vehicles under the newly effective FASB guidance.

On November 12, 2009, the FDIC issued an Interim Final Rule which preserves the legal isolation treatment applicable under the existing FDIC rule for asset-backed securities issued on or before March 31, 2010. The FDIC interim rule has lifted the uncertainty of existing securitizations and both TALF and non-TALF issuance on or before March 31, 2010. However, issuances beyond March 31, 2010 are subject to the final determination by the FDIC of the legal isolation standard. On December 15, 2009, the FDIC issued an Advance Notice of Proposed Rulemaking, which describes a possible framework for legal isolation treatment of asset-backed securities issued after March 31, 2010. The form that this rule will ultimately take is uncertain at this time, but it may impact our ability and/or desire to issue asset-backed securities in the future.

At November 30, 2009, we had $19.6 billion of outstanding public asset-backed securities, $2.7 billion of outstanding private asset-backed conduit financings and $4.6 billion of outstanding asset-backed securities that had been issued to subsidiaries of the Company. At November 30, 2009, we had $1.5 billion in unused asset-backed conduit capacity.

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The following table summarizes expected maturities of the investors interests in securitizations excluding those that have been issued to subsidiaries of the Company at November 30, 2009 (dollars in thousands):

	Total	Less Than One Year	One Year Through Three Years	Four Years Through Five Years	After Five Years
Scheduled maturities of the investors interests in securitizations issued to third parties	$ 22,305,269	$ 9,923,686	$ 9,263,160	$ 2,118,423	$ 1,000,000

We access the public asset-backed securitization market through DCMT and DCENT, using receivables generated by our credit card business. Through DCMT we have used a structure utilizing Class A and Class B certificates held by third parties, with credit enhancement provided by the subordinated Class B certificates, a cash collateral account and a more subordinated Series 2009-CE certificate described below. DCENT consists of four classes of securities (Class A, B, C and D), with credit enhancement provided by the subordinated classes of notes. As of November 30, 2009, $2.3 billion of Class B and C notes are owned by subsidiaries of Discover Bank. We have completed the following transactions for DCMT and DCENT since mid-2009:

In the third quarter of 2009, we issued the DiscoverSeries Class D (2009-1) note from DCENT that added 6.5% credit enhancement to all outstanding notes of the DiscoverSeries and is available to support new issuances of DiscoverSeries notes through increases in the stated principal amount. On November 30, 2009, the stated principal amount of the Class D notes was $829 million, which was approximately 6.5% of the then outstanding notes of DCENT including the Class D notes. In January 2010, we increased the size of the Class D (2009-1) note to further support the more senior DCENT securities. A wholly-owned subsidiary of Discover Bank owns the DCENT Class D (2009-1) note.

In the third quarter of 2009, we issued Series 2009-CE from DCMT to provide credit enhancement to DCMT investor certificates. This subordinate series supports all outstanding series of DCMT other than Series 2007-CC (which supports the DCENT notes, for which the DiscoverSeries Class D notes were issued). On November 30, 2009, the stated principal amount of this subordinate series was $902 million, which is generally equivalent to 6.5% of the series investor interests, including the subordinate series. DCMT Series 1996-4, which had lower initial levels of credit enhancement, received additional credit enhancement through the subordinate series in an amount bringing its enhancement levels in line with other comparable series of DCMT certificates. In January 2010, we increased the size of Series 2009-CE to further support the more senior DCMT certificates. The DCMT Series 2009-CE investor certificates are owned by a wholly-owned subsidiary of Discover Bank.

In addition, in September 2009 we issued Series 2009-SD from DCMT to enhance excess spread for all outstanding series of investor certificates and tranches of DiscoverSeries notes. Series 2009-SD makes all of its principal collections available for reallocation on an as-needed basis to all outstanding series (including the DiscoverSeries) to cover shortfalls in interest and servicing fees and to reimburse charge-offs for those other series. The availability of these principal collections increases excess spread levels for DCMT and for the DiscoverSeries notes. The Series 2009-SD interest will remain equal to approximately 2.0% of the total investors interests. The DCMT Series 2009-SD investor certificates are owned by a wholly-owned subsidiary of Discover Bank.

The securitization structures include certain features designed to protect investors that could result in earlier than expected repayment of the underlying securities, accelerating the need for alternative funding. The primary feature relates to the availability and adequacy of cash flows in the securitized pool of receivables to meet contractual requirements, the insufficiency of which triggers early repayment of the securities. We refer to this as economic early amortization, which is based on excess spread levels. Excess spread is the amount by which income received by a trust during a collection period, including interest collections, fees and interchange, as well as the amount of certain principal collections available to be reallocated from Series 2009-SD, exceeds the fees and expenses of the trust during such collection period, including interest expense, servicing fees and charged-off receivables. In the event of an economic early amortization, which would occur if the excess spread falls below 0% for a contractually specified period, generally a three-month rolling average, we would be required to repay the affected outstanding securitized borrowings over a period of a few months. As of November 30, 2009, no economic early amortization events have occurred.

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The tables below provide information concerning investors interests and related excess spreads at November 30, 2009 (dollars in thousands):

	Investors Interests(1)	# of Series Outstanding
Discover Card Master Trust I	$ 14,134,204	16
Discover Card Execution Note Trust (DiscoverSeries notes)	12,759,358	27
Total investors interests	$ 26,893,562	43

(1) Effective July 31, 2009, all DCMT certificates and all notes issued by DCENT include cash flows derived from merchant discount and interchange revenue earned by Discover card.

	3-Month Rolling Average Excess Spread(1)(2)
Group excess spread percentage	11.43%
DiscoverSeries excess spread percentage	10.57%

(1) DCMT certificates refer to the higher of the Group excess spreads (as shown above) or their applicable series excess spreads in assessing whether an economic early amortization has occurred. DiscoverSeries notes refer to the higher of the Group or DiscoverSeries excess spreads (both of which are shown above) in assessing whether an economic early amortization has occurred.
(2) Discount Series (DCMT 2009-SD), which was issued in September 2009, makes principal collections available for reallocation to other series to cover shortfalls in interest and servicing fees and to reimburse charge-offs. Three-month rolling average excess spread rates reflected the benefit of these additional collections.

As of November 30, 2009, the balance of cash collateral account loans supporting DCMT, which we had funded, was $842.4 million and is recorded in amounts due from asset securitization in our consolidated statement of financial condition at its fair value of $822.6 million. A majority of this funding was obtained through a loan facility entered into between a consolidated special purpose subsidiary, DRFC Funding LLC, and third-party lenders. At November 30, 2009, $528.2 million of the DRFC Funding LLC loan facility remains outstanding and is recorded in long-term borrowings in our consolidated statement of financial condition. Repayment of this loan facility is secured by $792.4 million of cash collateral account loans at November 30, 2009. This portion of the cash collateral account loans was sold to DRFC Funding LLC and is not expected to be available to creditors of Discover Financial Services.

The following table summarizes estimated maturities of the cash collateral accounts at November 30, 2009 (dollars in thousands):

	Total	Less Than One Year	One Year Through Three Years	Four Years Through Five Years	After Five Years
Scheduled maturities of cash collateral accounts	$ 842,369	$ 382,895	$ 311,842	$ 147,632	$

Short-Term Borrowings. In the past, we have accessed short-term borrowings through the Federal Reserve s Term Auction Facility, term and overnight Federal Funds purchased, and other short-term borrowings with original maturities of less than one year. However, we had no outstanding short-term borrowings at November 30, 2009.

Long-Term Borrowings and Bank Notes. In 2009, we successfully accessed the unsecured debt market. We issued $400 million in principal amount of senior unsecured notes in the third quarter of 2009 with a fixed rate of 10.25% that mature in July 2019. In the fourth quarter of 2009, Discover Bank issued $700 million of subordinated notes with a fixed interest rate of 8.70% that mature in November 2019.

At November 30, 2009, we had $1.2 billion senior unsecured notes outstanding including $400 million in principal amount of floating rate senior unsecured notes, which mature in June 2010, and two $400 million fixed rate senior unsecured notes that mature in June 2017 and July 2019, respectively. At November 30, 2009, we had $700 million in principal amount of subordinated notes outstanding that mature in November 2019.

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Additional Funding Sources

Secured Committed Credit Facilities. We have access to committed undrawn funding capacity through privately placed asset-backed conduits to support credit card loan receivables funding requirements. At November 30, 2009, we had used $2.7 billion of capacity under these conduits, with $1.5 billion remaining capacity available to us. The original commitments of these facilities range from 364-day renewable agreements to multi-year extendable commitments.

Unsecured Committed Credit Facility. Our unsecured committed credit facility of $2.4 billion is available through May 2012. This facility serves to diversify our funding sources and enhance our liquidity. This facility is provided by a group of major global banks, and is available to both Discover Financial Services and Discover Bank (Discover Financial Services may borrow up to 30% and Discover Bank may borrow up to 100% of the total commitment). We anticipate that the facility will support general liquidity needs and may be drawn to meet short-term funding needs from time to time. We have no outstanding balances due under the facility.

Federal Reserve. Discover Bank has access to the Federal Reserve Bank of Philadelphia s discount window. As of November 30, 2009, Discover Bank had $4.8 billion of available capacity through the discount window, which includes $2.4 billion capacity through the Term Auction Facility. Our Federal Reserve available capacity decreased in the fourth quarter of 2009 due to the Federal Reserve decreasing the amount it will lend against certain loans pledged as collateral.

ECASLA. In May 2008, Congress passed the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA). ECASLA provides originators of Federal Family Education Loan Program (FFELP) loans with the ability to transfer qualifying FFELP loans to the Department of Education through participation and loan sale programs and/or finance FFELP loans through an asset-backed conduit program. ECASLA provides us with a potential source of funding and liquidity with respect to qualifying FFELP loans originated by Discover Bank.

Credit Ratings

Our borrowing costs and capacity in certain funding markets, including securitizations and senior and subordinated debt, may be affected by the credit ratings for Discover Financial Services, Discover Bank and the securitization trusts. A credit rating is not a recommendation to buy, sell or hold securities, may be subject to revision or withdrawal at any time by the assigning rating organization, and each rating should be evaluated independently of any other rating. The credit ratings are summarized in the following table:

	Discover Financial Services Senior Unsecured Debt	Discover Bank Senior Unsecured Debt	Outlook for Senior Unsecured Debt	Discover Card Master Trust I(1)		Discover Card Execution Note Trust(1)		
				Class A	Class B	Class A	Class B	Class C
Moody s Investors Service	Ba1	Baa3	Negative	Aaa	A1	Aaa	A1	Baa1
Standard & Poor s	BBB-	BBB	Stable	AAA	AA	AAA	AA	A-
Fitch Ratings	BBB	BBB	Negative	AAA	AA	AAA	AA-	A-

(1) Ratings are for outstanding issuances of asset-backed securities issued by the trusts that mature after May 2010.

Liquidity

We seek to ensure that we have adequate liquidity to sustain business operations, fund asset growth and satisfy debt obligations. We expect to be able to satisfy all maturing obligations and fund business activities in the short term and long term through normal access to our funding sources, relying primarily on deposit issuance.

In the assessment of our liquidity needs, we also evaluate a range of stress events that would impact our access to normal funding sources, cash needs and/or liquidity. We maintain contingent funding sources, including our liquidity reserve, remaining asset-backed conduit capacity, committed credit facility capacity and Federal Reserve discount window capacity, that we could utilize to satisfy liquidity needs during such stress events. In the event that access to capital markets, including the securitization market, is unavailable during the next twelve months, we believe that we would be able to satisfy all maturing obligations and fund business operations during that time by utilizing our deposit channels and our contingent funding sources.

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Our liquidity reserve is comprised of cash and cash equivalents and other investments. Cash and cash equivalents are invested primarily in deposits with the Federal Reserve, highly-rated certificates of deposit, and triple-A rated government mutual funds with maturities of 90 days or less when purchased. Other investments include certificates of deposit with maturities greater than 90 days and certain credit card asset-backed securities of other issuers. The level of our liquidity reserve may fluctuate based upon the level of expected maturities of our funding sources as well as operational requirements and market conditions.

During 2009, we increased our liquidity reserve by $4.8 billion to $14.2 billion at November 30, 2009, in anticipation of approximately $19 billion in maturities of asset-backed securities, certificates of deposit and senior unsecured notes in 2010, of which $12.5 billion are due in the first half of 2010.

	November 30,	
	2009	**2008**
	(dollars in billions)	
Liquidity reserve		
Cash and cash equivalents[1]	$ 12.7	$ 9.4
Other investments		