Discover Financial Services
Form 10-Q
July 29, 2015

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

x	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended June 30, 2015
o	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the transition period from to

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

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

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

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

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

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

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

As of July 24, 2015, there were 435,306,766 shares of the registrant's Common Stock, par value $0.01 per share, outstanding.

DISCOVER FINANCIAL SERVICES
Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2015
TABLE OF CONTENTS

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

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

Table of Contents

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

	June 30, 2015 (unaudited)	December 31, 2014
	(dollars in millions, except share amounts)	
Assets		
Cash and cash equivalents	$10,595	$ 7,284
Restricted cash	754	106
Investment securities (includes $2,574 and $3,847 at fair value at June 30, 2015 and December 31, 2014, respectively)	2,701	3,949
Loan receivables		
Loan receivables (includes $155 and $122 at fair value at June 30, 2015 and December 31, 2014, respectively)	69,028	69,969
Allowance for loan losses	(1,735)	(1,746)
Net loan receivables	67,293	68,223
Premises and equipment, net	688	670
Goodwill	255	257
Intangible assets, net	170	176
Other assets	2,455	2,461
Total assets	$84,911	$ 83,126
Liabilities and Stockholders' Equity		
Deposits		
Interest-bearing deposit accounts	$45,989	$ 45,792
Non-interest bearing deposit accounts	327	297
Total deposits	46,316	46,089
Short-term borrowings	144	113
Long-term borrowings	24,099	22,544
Accrued expenses and other liabilities	3,089	3,246
Total liabilities	73,648	71,992
Commitments, contingencies and guarantees (Notes 9, 12 and 13)		
Stockholders' Equity:		
Common stock, par value $0.01 per share; 2,000,000,000 shares authorized; 560,610,832 and 558,194,324 shares issued at June 30, 2015 and December 31, 2014, respectively	5	5
Preferred stock, par value $0.01 per share; 200,000,000 shares authorized; 575,000 shares issued and outstanding and aggregate liquidation preference of $575 at June 30, 2015 and December 31, 2014	560	560
Additional paid-in capital	3,853	3,790
Retained earnings	12,400	11,467
Accumulated other comprehensive loss	(160)	(138)
Treasury stock, at cost; 123,228,522 and 109,006,038 shares at June 30, 2015 and December 31, 2014, respectively	(5,395)	(4,550)
Total stockholders' equity	11,263	11,134
Total liabilities and stockholders' equity	$84,911	$ 83,126

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

	June 30, 2015	December 31, 2014
	(unaudited)	
	(dollars in millions)	
Assets		
Restricted cash	$749	$ 102
Loan receivables	$30,470	$ 32,304
Allowance for loan losses allocated to securitized loan receivables	$(787)	$ (833)
Other assets	$37	$ 37
Liabilities		
Long-term borrowings	$17,190	$ 17,395
Accrued expenses and other liabilities	$11	$ 11

See Notes to the Condensed Consolidated Financial Statements.
1

Table of Contents

DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Income

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(unaudited)			
	(dollars in millions, except per share amounts)			
Interest income				
Credit card loans	$1,620	$1,560	$3,226	$3,097
Other loans	308	282	612	557
Investment securities	12	17	25	33
Other interest income	7	4	13	9
Total interest income	1,947	1,863	3,876	3,696
Interest expense				
Deposits	155	151	307	304
Short-term borrowings	—	—	1	1
Long-term borrowings	156	123	303	239
Total interest expense	311	274	611	544
Net interest income	1,636	1,589	3,265	3,152
Provision for loan losses	306	360	696	632
Net interest income after provision for loan losses	1,330	1,229	2,569	2,520
Other income				
Discount and interchange revenue, net	298	327	566	581
Protection products revenue	68	78	139	161
Loan fee income	80	80	161	163
Transaction processing revenue	40	46	82	90
Gain on investments	—	—	8	4
Gain on origination and sale of mortgage loans	26	22	66	38
Other income	27	30	59	61
Total other income	539	583	1,081	1,098
Other expense				
Employee compensation and benefits	326	301	657	608
Marketing and business development	199	168	381	337
Information processing and communications	90	87	178	171
Professional fees	153	112	280	211
Premises and equipment	23	22	47	45
Other expense	136	107	257	209
Total other expense	927	797	1,800	1,581
Income before income tax expense	942	1,015	1,850	2,037
Income tax expense	343	371	665	762
Net income	$599	$644	$1,185	$1,275
Net income allocated to common stockholders	$586	$630	$1,159	$1,248
Basic earnings per common share	$1.33	$1.35	$2.61	$2.66
Diluted earnings per common share	$1.33	$1.35	$2.61	$2.66
Dividends declared per common share	$0.28	$0.24	$0.52	$0.44

See Notes to the Condensed Consolidated Financial Statements.

Table of Contents

DISCOVER FINANCIAL SERVICES
Condensed Consolidated Statements of Comprehensive Income

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(unaudited) (dollars in millions)			
Net income	$599	$644	$1,185	$1,275
Other comprehensive income (loss), net of taxes				
Unrealized (loss) gain on available-for-sale investment securities, net of tax	(10)	8	(10)	10
Unrealized gain (loss) on cash flow hedges, net of tax	11	(10)	(12)	(14)
Other comprehensive income (loss)	1	(2)	(22)	(4)
Comprehensive income	$600	$642	$1,163	$1,271

See Notes to the Condensed Consolidated Financial Statements.

Table of Contents

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

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Stockholders' Equity
	Shares	Amount	Shares	Amount					
	(unaudited) (dollars in millions, shares in thousands)								
Balance at December 31, 2013	575	$560	555,350	$5	$ 3,687	$9,611	$ (68)	$(2,986)	$ 10,809
Net income	—	—	—	—	—	1,275	—	—	1,275
Other comprehensive loss	—	—	—	—	—	—	(4)	—	(4)
Purchases of treasury stock	—	—	—	—	—	—	—	(543)	(543)
Common stock issued under employee benefit plans	—	—	30	—	2	—	—	—	2
Common stock issued and stock-based compensation expense	—	—	2,716	—	69	—	—	—	69
Dividends — common stock	—	—	—	—	—	(208)	—	—	(208)
Dividends — preferred stock	—	—	—	—	—	(19)	—	—	(19)
Balance at June 30, 2014	575	$560	558,096	$5	$ 3,758	$10,659	$ (72)	$(3,529)	$ 11,381
Balance at December 31, 2014	575	$560	558,194	$5	$ 3,790	$11,467	$ (138)	$(4,550)	$ 11,134
Net income	—	—	—	—	—	1,185	—	—	1,185
Other comprehensive loss	—	—	—	—	—	—	(22)	—	(22)
Purchases of treasury stock	—	—	—	—	—	—	—	(845)	(845)
Common stock issued under employee benefit plans	—	—	39	—	2	—	—	—	2
Common stock issued and stock-based compensation expense	—	—	2,378	—	61	—	—	—	61
Dividends — common stock	—	—	—	—	—	(233)	—	—	(233)

Dividends — preferred stock	—	—	—	—	—	(19)	—	—	(19)
Balance at June 30, 2015	575	$560	560,611	$5	$ 3,853	$12,400	$ (160)	$(5,395)	$ 11,263

See Notes to the Condensed Consolidated Financial Statements.

4

DISCOVER FINANCIAL SERVICES

Condensed Consolidated Statements of Cash Flows

	For the Six Months Ended June 30,	
	2015	2014
	(unaudited) (dollars in millions)	
Cash flows from operating activities		
Net income	$1,185	$1,275
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	696	632
Depreciation and amortization	193	181
Amortization of deferred revenues and accretion of accretable yield on acquired loans	(221)	(239)
Net gain on origination and sale of loans, investments and other assets	(49)	(30)
Proceeds from sale of mortgage loans originated for sale	2,232	1,162
Net principal disbursed on mortgage loans originated for sale	(2,202)	(1,103)
Other, net	15	80
Changes in assets and liabilities:		
Increase in other assets	(75)	(70)
Decrease in accrued expenses and other liabilities	(111)	(117)
Net cash provided by operating activities	1,663	1,771
Cash flows from investing activities		
Maturities and sales of available-for-sale investment securities	1,257	1,331
Purchases of available-for-sale investment securities	—	(244)
Maturities of held-to-maturity investment securities	7	8
Purchases of held-to-maturity investment securities	(32)	(18)
Net principal repaid (disbursed) on loans originated for investment	486	(545)
Purchases of other investments	(23)	(34)
Increase in restricted cash	(648)	(123)
Purchases of premises and equipment	(88)	(73)
Net cash provided by investing activities	959	302
Cash flows from financing activities		
Net increase (decrease) in short-term borrowings	31	(20)
Proceeds from issuance of securitized debt	1,750	2,650
Maturities and repayment of securitized debt	(1,971)	(3,492)
Proceeds from issuance of other long-term borrowings	1,749	399
Proceeds from issuance of common stock	3	2
Purchases of treasury stock	(845)	(543)
Net increase (decrease) in deposits	226	(516)
Dividends paid on common and preferred stock	(254)	(228)
Net cash provided by (used for) financing activities	689	(1,748)
Net increase in cash and cash equivalents	3,311	325
Cash and cash equivalents, at beginning of period	7,284	6,554
Cash and cash equivalents, at end of period	$10,595	$6,879

See Notes to the Condensed Consolidated Financial Statements.

5

Table of Contents

Notes to the Condensed Consolidated Financial Statements
(unaudited)

1. Background and Basis of Presentation

Description of Business

Discover Financial Services ("DFS" or the "Company") is a direct banking and payment services company. The Company is a bank holding company under the Bank Holding Company Act of 1956 as well as a financial holding company under the Gramm-Leach-Bliley Act and therefore is subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company provides direct banking products and services and payment services through its subsidiaries. The Company offers its customers credit card loans, private student loans, personal loans, home equity loans and deposit products. The Company also operates the Discover Network, the PULSE network ("PULSE") and Diners Club International ("Diners Club"). The Discover Network processes transactions for Discover-branded credit cards and also provides payment transaction processing and settlement services. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE network with access to ATMs domestically and internationally, as well as point-of-sale terminals at retail locations throughout the U.S. for debit card transactions. Diners Club is a global payments network of licensees, which are generally financial institutions, that issue Diners Club branded charge cards and/or provide card acceptance services.

The Company's business segments are Direct Banking and Payment Services. The Direct Banking segment includes consumer banking and lending products, specifically Discover-branded credit cards issued to individuals on the Discover Network and other consumer products and services, including private student loans, personal loans, home loans, home equity loans, prepaid cards and other consumer lending and deposit products. The majority of Direct Banking revenues relate to interest income earned on the segment's loan products. Additionally, the Company's credit card products generate substantially all revenues related to discount and interchange, protection products and loan fee income.

The Payment Services segment includes PULSE, Diners Club and the Company's Network Partners business, which provides payment transaction processing and settlement services on the Discover Network. This segment also includes the business operations of Diners Club Italy, which primarily consist of issuing Diners Club charge cards. The majority of Payment Services revenues relate to transaction processing revenue from PULSE and royalty and licensee revenue (included in other income) from Diners Club.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, the financial statements reflect all adjustments which are necessary for a fair presentation of the results for the interim period. All such adjustments are of a normal, recurring nature. The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and related disclosures. These estimates are based on information available as of the date of the condensed consolidated financial statements. The Company believes that the estimates used in the preparation of the condensed consolidated financial statements are reasonable. Actual results could differ from these estimates. These interim condensed consolidated financial statements should be read in conjunction with the Company's 2014 audited consolidated financial statements filed with the Company's annual report on Form 10-K for the calendar year ended December 31, 2014.

Recently Issued Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-05, Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. This ASU addresses whether a cloud computing arrangement contains a software license. Under the new guidance, a cloud computing arrangement contains a software license if the customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty and provided it is feasible for the customer to either host the software internally or with an external party unrelated to the original vendor. Upon meeting both of these criteria, a customer should account for the software license within a cloud computing arrangement in a manner consistent with the acquisition of other software licenses. If a cloud computing arrangement does not meet both criteria, a customer will account for the arrangement entirely as a service contract. The new guidance will become effective for the Company on January 1, 2016. Management is in the process of evaluating existing contractual arrangements to determine whether any will be impacted by the ASU.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The guidance in this update was issued to improve targeted areas of the accounting rules for consolidation. The ASU changes the analysis companies will use to determine if certain types of legal entities should be consolidated. In addition, it modifies the determination of whether a limited partnership ("LP") should be evaluated as a VIE or a voting interest entity and eliminates the presumption that a general partner should consolidate a LP. The amendments will primarily trigger a review of the Company's tax credit investments, which typically utilize limited liability entities. Management is in the process of reviewing those and all other involvements with potential VIEs to determine if its prior conclusions about consolidation or non-consolidation of those entities continue to be appropriate in light of the amended guidance. The new guidance will become effective for the Company on January 1, 2016.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). The guidance in this update supersedes existing revenue recognition requirements in Topic 605, Revenue Recognition, including an assortment of transaction-specific and industry-specific rules. The ASU establishes a principles-based model under which revenue from a contract is allocated to the distinct performance obligations within the contract and recognized in income as each performance obligation is satisfied. ASU Topic 606 does not apply to rights or obligations associated with financial instruments (for example, interest income from loans or investments, or interest expense on debt), and therefore the Company's net interest income should not be affected. The Company's revenue from discount and interchange, protection products, transaction processing and certain fees are within the scope of these rules. Management has not yet completed its evaluation of the impact, if any, of the new guidance on these revenues. As issued, the new revenue recognition rules were to become effective January 1, 2017. The FASB deferred the effective date to January 1, 2018. Upon adoption in 2018, the Company will record an adjustment to retained earnings as of the beginning of the year of initial application, which can be either the earliest comparative period presented, with all periods presented under the new rules, or January 1, 2018, without restating prior periods presented. Management has not yet determined which transition reporting option it will apply.

2. Business Dispositions

On June 16, 2015, the Company announced that it is closing the mortgage origination business it acquired in 2012, which is part of its Direct Banking segment. The disposition represents the exiting of an ancillary business that will not have a major impact on the Company's operations. As part of the restructuring, the Company incurred approximately $23 million of restructuring expenses for the three and six months ended June 30, 2015, recorded in other expense within the condensed consolidated statements of income, and expects to incur restructuring expenses of approximately $10 million through the end of the wind-down period of the business over the remainder of 2015.

3. Investments

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

	June 30, 2015	December 31, 2014
U.S. Treasury securities[1]	$607	$ 1,330
U.S. government agency securities	625	1,033
States and political subdivisions of states	10	10
Residential mortgage-backed securities - Agency[2]	1,459	1,576
Total investment securities	$2,701	$ 3,949

(1) Includes $13 million and $16 million of U.S. Treasury securities pledged as swap collateral in lieu of cash as of June 30, 2015 and December 31, 2014, respectively.

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

6

Table of Contents

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At June 30, 2015				
Available-for-Sale Investment Securities[1]				
U.S. Treasury securities	$601	$5	$—	$606
U.S. government agency securities	619	6	—	625
Residential mortgage-backed securities - Agency	1,334	11	(2)	1,343
Total available-for-sale investment securities	$2,554	$22	$(2)	$2,574
Held-to-Maturity Investment Securities[2]				
U.S. Treasury securities[3]	$1	$—	$—	$1
States and political subdivisions of states	10	—	—	10
Residential mortgage-backed securities - Agency[4]	116	1	—	117
Total held-to-maturity investment securities	$127	$1	$—	$128
At December 31, 2014				
Available-for-Sale Investment Securities[1]				
U.S. Treasury securities	$1,317	$12	$—	$1,329
U.S. government agency securities	1,021	12	—	1,033
Residential mortgage-backed securities - Agency	1,473	13	(1)	1,485
Total available-for-sale investment securities	$3,811	$37	$(1)	$3,847
Held-to-Maturity Investment Securities[2]				
U.S. Treasury securities[3]	$1	$—	$—	$1
States and political subdivisions of states	10	—	—	10
Residential mortgage-backed securities - Agency[4]	91	2	—	93
Total held-to-maturity investment securities	$102	$2	$—	$104

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

The following table provides information about investment securities with aggregate gross unrealized losses and the length of time that individual investment securities have been in a continuous unrealized loss position (dollars in millions).

	Number of Securities in a Loss Position	Less than 12 months		More than 12 months	
		Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
At June 30, 2015					
Available-for-Sale Investment Securities					
Residential mortgage-backed securities - Agency	10	$397	$(2)	$—	$—
At December 31, 2014					
Available-for-Sale Investment Securities					

Residential mortgage-backed securities - Agency	8	$97	$—	$225	$(1)

There were no losses related to other-than-temporary impairments during the three and six months ended June 30, 2015 and 2014, respectively.

7

Table of Contents

The following table provides information about proceeds from sales, recognized gains and losses and net unrealized gains and losses on available-for-sale securities (dollars in millions):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Proceeds from the sales of available-for-sale investment securities	$—	$—	$899	$1,220
Gain on sales of available-for-sale investment securities	$—	$—	$8	$4
Net unrealized (loss) gain recorded in other comprehensive income, before-tax	$(16)	$13	$(16)	$16
Net unrealized (loss) gain recorded in other comprehensive income, after-tax	$(10)	$8	$(10)	$10

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

	One Year or Less	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years	Total
At June 30, 2015					
Available-for-Sale Investment Securities—Amortized Cost					
U.S. Treasury securities	$351	$250	$—	$—	$601
U.S. government agency securities	326	293	—	—	619
Residential mortgage-backed securities - Agency	—	—	437	897	1,334
Total available-for-sale investment securities	$677	$543	$437	$897	$2,554
Held-to-Maturity Investment Securities—Amortized Cost					
U.S. Treasury securities	$1	$—	$—	$—	$1
State and political subdivisions of states	—	—	—	10	10
Residential mortgage-backed securities - Agency	—	—	—	116	116
Total held-to-maturity investment securities	$1	$—	$—	$126	$127
Available-for-Sale Investment Securities—Fair Values					
U.S. Treasury securities	$354	$252	$—	$—	$606
U.S. government agency securities	329	296	—	—	625
Residential mortgage-backed securities - Agency	—	—	439	904	1,343
Total available-for-sale investment securities	$683	$548	$439	$904	$2,574
Held-to-Maturity Investment Securities—Fair Values					
U.S. Treasury securities	$1	$—	$—	$—	$1
State and political subdivisions of states	—	—	—	10	10
Residential mortgage-backed securities - Agency	—	—	—	117	117
Total held-to-maturity investment securities	$1	$—	$—	$127	$128

Other Investments

As a part of the Company's community reinvestment initiatives, the Company has made equity investments in certain limited partnerships and limited liability companies that finance the construction and rehabilitation of affordable rental housing, as well as stimulate economic development in low to moderate income communities. These investments are accounted for using the equity method of accounting and are recorded within other assets. The related commitment for future investments is recorded in accrued expenses and other liabilities within the condensed consolidated statements of financial condition. The portion of each investment's operating results allocable to the Company is recorded in other expense within the condensed consolidated statements of income. The Company earns a return primarily through the receipt of tax credits allocated to the affordable housing projects and the community revitalization projects. These investments are not consolidated as the Company does not have a controlling financial interest in the entities. As of June 30, 2015 and December 31, 2014, the Company had outstanding investments in these entities of $307 million and $325 million, respectively, and related contingent liabilities of $37 million and $51 million, respectively. Of the above outstanding equity investments, the Company had $200 million and $201 million, respectively, of investments related to affordable housing projects, which had $37 million and $38 million related contingent liabilities as of June 30, 2015 and December 31, 2014, respectively.

Table of Contents

4. Loan Receivables

The Company has three loan portfolio segments: credit card loans, other loans and purchased credit-impaired ("PCI") loans.

The Company's classes of receivables within the three portfolio segments are depicted in the table below (dollars in millions):

	June 30, 2015	December 31, 2014
Loan receivables		
Credit card loans[1]	$54,949	$ 56,128
Other loans		
Personal loans	5,183	5,007
Private student loans	5,139	4,850
Mortgage loans held for sale[2]	155	122
Other[3]	221	202
Total other loans	10,698	10,181
Purchased credit-impaired loans[4]	3,381	3,660
Total loan receivables	69,028	69,969
Allowance for loan losses	(1,735)	(1,746)
Net loan receivables	$67,293	$ 68,223

(1) Amounts include $21.7 billion underlying investors' interest in trust debt at June 30, 2015 and December 31, 2014 and $7.0 billion and $8.6 billion in seller's interest at June 30, 2015 and December 31, 2014, respectively. See Note 5: Credit Card and Student Loan Securitization Activities for further information.

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

(3) Other includes home equity loans.

(4) Amounts include $1.8 billion and $2.0 billion of loans pledged as collateral against the notes issued from the Student Loan Corporation ("SLC") securitization trusts at June 30, 2015 and December 31, 2014, respectively. See Note 5: Credit Card and Student Loan Securitization Activities.

Credit Quality Indicators

The Company regularly reviews its collection experience (including delinquencies and net charge-offs) in determining its allowance for loan losses.

Table of Contents

Information related to the delinquent and non-accruing loans in the Company's loan portfolio is shown below by each class of loan receivables except for mortgage loans held for sale and PCI student loans, which is shown under the heading "— Purchased Credit-Impaired Loans" (dollars in millions):

	30-89 Days Delinquent	90 or More Days Delinquent	Total Past Due	90 or More Days Delinquent and Accruing	Total Non-accruing[1]
At June 30, 2015					
Credit card loans[2]	$436	$414	$850	$369	$ 171
Other loans					
Personal loans[3]	27	10	37	9	6
Private student loans (excluding PCI)[4]	66	25	91	25	—
Other	1	1	2	—	23
Total other loans (excluding PCI)	94	36	130	34	29
Total loan receivables (excluding PCI)	$530	$450	$980	$403	$ 200
At December 31, 2014					
Credit card loans[2]	$491	$480	$971	$442	$ 157
Other loans					
Personal loans[3]	29	11	40	10	5
Private student loans (excluding PCI)[4]	62	25	87	25	—
Other	1	1	2	—	21
Total other loans (excluding PCI)	92	37	129	35	26
Total loan receivables (excluding PCI)	$583	$517	$1,100	$477	$ 183

(1) The Company estimates that the gross interest income that would have been recorded in accordance with the original terms of non-accruing credit card loans was $7 million and $6 million for the three months ended June 30, 2015 and 2014, respectively, and $14 million and $13 million for the six months ended June 30, 2015 and 2014, respectively. The Company does not separately track the amount of gross interest income that would have been recorded in accordance with the original terms of loans. This amount was estimated based on customers' current balances and most recent interest rates.

(2) Credit card loans that are 90 or more days delinquent and accruing interest include $38 million and $43 million of loans accounted for as troubled debt restructurings at June 30, 2015 and December 31, 2014, respectively.

(3) Personal loans that are 90 or more days delinquent and accruing interest include $3 million of loans accounted for as troubled debt restructurings at June 30, 2015 and December 31, 2014.

(4) Private student loans that are 90 or more days delinquent and accruing interest include $3 million and $5 million of loans accounted for as troubled debt restructurings at June 30, 2015 and December 31, 2014, respectively.

Table of Contents

Net Charge-offs

Information related to the net charge-offs in the Company's loan portfolio is shown below by each class of loan receivables except for mortgage loans held for sale and PCI student loans, which is shown under the heading "—Purchased Credit-Impaired Loans" (dollars in millions):

	For the Three Months Ended June 30,					
	2015			2014		
	Net Charge-offs	Net Charge-off Rate		Net Charge-offs	Net Charge-off Rate	
Credit card loans	$307	2.28	%	$300	2.33	%
Other loans						
Personal loans	27	2.10	%	22	1.95	%
Private student loans (excluding PCI)	13	1.02	%	14	1.30	%
Other	—	—	%	1	0.90	%
Total other loans (excluding PCI)	40	1.51	%	37	1.59	%
Net charge-offs as a percentage of total loans (excluding PCI)	$347	2.16	%	$337	2.22	%
Net charge-offs as a percentage of total loans (including PCI)	$347	2.05	%	$337	2.08	%

	For the Six Months Ended June 30,					
	2015			2014		
	Net Charge-offs	Net Charge-off Rate		Net Charge-offs	Net Charge-off Rate	
Credit card loans	$626	2.34	%	$594	2.32	%
Other loans						
Personal loans	55	2.16	%	43	2.01	%
Private student loans (excluding PCI)	26	1.02	%	28	1.31	%
Other	—	—	%	1	1.07	%
Total other loans (excluding PCI)	81	1.54	%	72	1.63	%
Net charge-offs as a percentage of total loans (excluding PCI)	$707	2.21	%	$666	2.22	%
Net charge-offs as a percentage of total loans (including PCI)	$707	2.10	%	$666	2.08	%

As part of credit risk management activities, on an ongoing basis, the Company reviews information related to the performance of a customer’s account with the Company as well as information from credit bureaus, such as FICO or other credit scores, relating to the customer’s broader credit performance. FICO scores are generally obtained at origination of the account and are refreshed monthly or quarterly thereafter to assist in predicting customer behavior. Historically, the Company has noted that a significant proportion of delinquent accounts have FICO scores below 660.

Table of Contents

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

	Credit Risk Profile by FICO Score	
	660 and Above	Less than 660 or No Score
At June 30, 2015		
Credit card loans	83 %	17 %
Personal loans	97 %	3 %
Private student loans (excluding PCI)[1]	96 %	4 %
At December 31, 2014		
Credit card loans	83 %	17 %
Personal loans	96 %	4 %
Private student loans (excluding PCI)[1]	96 %	4 %

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

For private student loans, additional credit risk management activities include monitoring the amount of loans in forbearance. Forbearance allows borrowers experiencing temporary financial difficulties and willing to make payments, the ability to temporarily suspend payments. Eligible borrowers have a lifetime cap on forbearance of 12 months. At June 30, 2015 and December 31, 2014, there were $50 million and $49 million of private student loans, including PCI, in forbearance, respectively. In addition, at June 30, 2015 and December 31, 2014, there were 0.8% of private student loans in forbearance as a percentage of student loans in repayment and forbearance.

Table of Contents

Allowance for Loan Losses

The following tables provide changes in the Company's allowance for loan losses (dollars in millions):

	For the Three Months Ended June 30, 2015				
	Credit Card	Personal Loans	Student Loans(1)	Other	Total
Balance at beginning of period	$1,492	$123	$142	$19	$1,776
Additions					
Provision for loan losses	256	35	14	1	306
Deductions					
Charge-offs	(423)	(31)	(15)	—	(469)
Recoveries	116	4	2	—	122
Net charge-offs	(307)	(27)	(13)	—	(347)
Balance at end of period	$1,441	$131	$143	$20	$1,735

	For the Three Months Ended June 30, 2014				
	Credit Card	Personal Loans	Student Loans(1)	Other	Total
Balance at beginning of period	$1,342	$109	$122	$18	$1,591
Additions					
Provision for loan losses	317	22	20	1	360
Deductions					
Charge-offs	(415)	(24)	(15)	(1)	(455)
Recoveries	115	2	1	—	118
Net charge-offs	(300)	(22)	(14)	(1)	(337)
Balance at end of period	$1,359	$109	$128	$18	$1,614

	For the Six Months Ended June 30, 2015				
	Credit Card	Personal Loans	Student Loans(1)	Other	Total
Balance at beginning of period	$1,474	$120	$135	$17	$1,746
Additions					
Provision for loan losses	593	66	34	3	696
Deductions					
Charge-offs	(851)	(62)	(30)	—	(943)
Recoveries	225	7	4	—	236
Net charge-offs	(626)	(55)	(26)	—	(707)
Balance at end of period	$1,441	$131	$143	$20	$1,735

	For the Six Months Ended June 30, 2014				
	Credit Card	Personal Loans	Student Loans(1)	Other	Total
Balance at beginning of period	$1,406	$112	$113	$17	$1,648
Additions					
Provision for loan losses	547	40	43	2	632
Deductions					
Charge-offs	(823)	(48)	(30)	(1)	(902)
Recoveries	229	5	2	—	236
Net charge-offs	(594)	(43)	(28)	(1)	(666)
Balance at end of period	$1,359	$109	$128	$18	$1,614

(1) Includes both PCI and non-PCI private student loans.

Table of Contents

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Interest and fees accrued subsequently charged off, net of recoveries (recorded as a reduction of interest income)	$70	$70	$145	$142
Fees accrued subsequently charged off, net of recoveries (recorded as a reduction to other income)	$17	$17	$37	$34

Table of Contents

The following tables provide additional detail of the Company's allowance for loan losses and recorded investment in its loan portfolio by impairment methodology (dollars in millions):

	Credit Card	Personal Loans	Student Loans[3]	Other Loans[4]	Total
At June 30, 2015					
Allowance for loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	$1,284	$126	$102	$1	$1,513
Evaluated for impairment in accordance with ASC 310-10-35[1][2]	157	5	13	19	194
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	28	—	28
Total allowance for loan losses	$1,441	$131	$143	$20	$1,735
Recorded investment in loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	$53,939	$5,122	$5,096	$160	$64,317
Evaluated for impairment in accordance with ASC 310-10-35[1][2]	1,010	61	43	61	1,175
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	3,381	—	3,381
Total recorded investment	$54,949	$5,183	$8,520	$221	$68,873
At December 31, 2014					
Allowance for loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	$1,314	$114	$96	$1	$1,525
Evaluated for impairment in accordance with ASC 310-10-35[1][2]	160	6	11	16	193
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	28	—	28
Total allowance for loan losses	$1,474	$120	$135	$17	$1,746
Recorded investment in loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	$55,091	$4,952	$4,812	$142	$64,997
Evaluated for impairment in accordance with ASC 310-10-35[1][2]	1,037	55	38	60	1,190
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	3,660	—	3,660
Total recorded investment	$56,128	$5,007	$8,510	$202	$69,847

(1) Loan receivables evaluated for impairment in accordance with Accounting Standards Codification ("ASC") 310-10-35 include credit card loans, personal loans and student loans collectively evaluated for impairment in accordance with ASC Subtopic 310-40, Receivables, which consists of modified loans accounted for as troubled debt restructurings. Other loans are individually evaluated for impairment and generally do not represent troubled debt restructurings.

(2) The unpaid principal balance of credit card loans was $858 million and $878 million at June 30, 2015 and December 31, 2014, respectively. The unpaid principal balance of personal loans was $61 million and $54 million at June 30, 2015 and December 31, 2014, respectively. The unpaid principal balance of student loans was $42 million and $37 million at June 30, 2015 and December 31, 2014, respectively. All loans accounted for as troubled debt restructurings have a related allowance for loan losses.

(3) Includes both PCI and non-PCI private student loans.

(4) Excludes mortgage loans held for sale. Certain other loans, including non-performing Diners Club licensee loans, are individually evaluated for impairment.

Troubled Debt Restructurings

The Company has internal loan modification programs that provide relief to credit card, personal loan and student loan borrowers who are experiencing financial hardship. The internal loan modification programs include both temporary and permanent programs which vary by product. External loan modification programs are also available for credit card and personal loans. Temporary and permanent modifications on credit card and personal loans, as well as temporary modifications on student loans and certain grants of student loan forbearance, are considered to be individually impaired. In addition, loans that defaulted or graduated from modification programs or forbearance are considered to be individually impaired. As a result, the above mentioned loans are accounted for as troubled debt restructurings.

For credit card customers, the temporary hardship program primarily consists of a reduced minimum payment and an interest rate reduction, both lasting for a period no longer than 12 months. The permanent workout program involves

Table of Contents

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

To assist student loan borrowers who are experiencing temporary financial difficulties but are willing to resume making payments, the Company may offer hardship forbearance periods of up to 12 months over the life of the loan. Forbearance provides borrowers a deferment in making payments, during which time loan interest continues to accrue at contractual rates. The Company does not anticipate significant shortfalls in the contractual amount due for borrowers using a first hardship forbearance period as the historical performance of these borrowers is not significantly different from the overall portfolio. However, when a borrower is 30 or more days delinquent and granted a second hardship forbearance period, the forbearance is considered a troubled debt restructuring. In addition, the Company offers temporary reduced payment programs, which normally consist of a reduction of the minimum payment for a period of no longer than 12 months. When a student loan borrower is enrolled in a temporary reduced payment program for 12 months or fewer over the life of the loan, the modification is not considered a troubled debt restructuring. No loans have been in a temporary modification program for greater than 12 months.

For personal loan customers, in certain situations the Company offers various payment programs, including temporary and permanent programs. The temporary programs normally consist of a reduction of the minimum payment for a period of no longer than 12 months with the option of a final balloon payment required at the end of the loan term or an extension of the maturity date with the total term not exceeding nine years. Further, in certain circumstances the interest rate on the loan is reduced. The permanent program involves changing the terms of the loan in order to pay off the outstanding balance over a longer term and also in certain circumstances reducing the interest rate on the loan. Similar to the temporary programs, the total term may not exceed nine years. The Company also allows loan modifications for customers who request financial assistance through external sources, similar to the credit card customers discussed above. Payments are modified based on the new terms agreed upon with the credit counseling agency. Personal loans included in temporary and permanent programs are accounted for as troubled debt restructurings.

The Company monitors borrower performance after using payment programs or forbearance and the Company believes the programs help to prevent defaults and are useful in assisting customers experiencing financial difficulties. The Company plans to continue to use payment programs and forbearance and, as a result, expects to have additional loans classified as troubled debt restructurings in the future.

Table of Contents

Additional information about modified loans classified as troubled debt restructurings is shown below (dollars in millions):

	Average recorded investment in loans	Interest income recognized during period loans were impaired(1)	Gross interest income that would have been recorded with original terms(2)
For the Three Months Ended June 30, 2015			
Credit card loans			
Modified credit card loans(3)	$256	$12	$1
Internal programs	$450	$3	$15
External programs	$311	$6	$3
Personal loans	$60	$1	$—
Private student loans	$42	$1	N/A
For the Three Months Ended June 30, 2014			
Credit card loans			
Modified credit card loans(3)	$249	$12	$1
Internal programs	$452	$3	$16
External programs	$373	$7	$3
Personal loans	$46	$1	$1
Private student loans	$31	$—	N/A
For the Six Months Ended June 30, 2015			
Credit card loans			
Modified credit card loans(3)	$256	$23	$2
Internal programs	$451	$6	$30
External programs	$317	$12	$6
Personal loans	$58	$3	$1
Private student loans	$41	$2	N/A
For the Six Months Ended June 30, 2014			
Credit card loans			
Modified credit card loans(3)	$253	$23	$2
Internal programs	$453	$6	$31
External programs	$384	$14	$6
Personal loans	$45	$2	$1
Private student loans	$30	$1	N/A

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

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

(3) This balance is considered impaired, but is excluded from the internal and external program amounts reflected in this table. Represents credit card loans that were modified in troubled debt restructurings, but are no longer

enrolled in troubled debt restructuring program due to noncompliance with the terms of the modification or successful completion of a program.

In order to evaluate the primary financial effects that resulted from credit card loans entering into a loan modification program during the three and six months ended June 30, 2015 and 2014, the Company quantified the amount by which interest and fees were reduced during the periods. During the three months ended June 30, 2015 and 2014, the Company forgave approximately $11 million and $9 million, respectively, of interest and fees as a result of accounts entering into a credit card loan modification program. During the six months ended June 30, 2015 and 2014, the Company forgave approximately $22 million and $19 million, respectively, of interest and fees as a result of accounts entering into a credit card loan modification program.

Table of Contents

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

	For the Three Months Ended June 30,			
	2015		2014	
	Number of Accounts	Balances	Number of Accounts	Balances
Accounts that entered a loan modification program during the period				
Credit card loans:				
Internal programs	11,989	$78	10,648	$71
External programs	7,296	$37	7,824	$42
Personal loans	989	$12	820	$10
Private student loans	291	$4	345	$5

	For the Six Months Ended June 30,			
	2015		2014	
	Number of Accounts	Balances	Number of Accounts	Balances
Accounts that entered a loan modification program during the period				
Credit card loans				
Internal programs	25,232	$164	23,084	$152
External programs	14,913	$76	16,255	$86
Personal loans	1,975	$24	1,532	$18
Private student loans	760	$11	652	$9

Table of Contents

The following table presents the carrying value of loans that experienced a payment default during the period that had been modified in a troubled debt restructuring during the 15 months preceding the end of each period (dollars in millions):

	For the Three Months Ended June 30,			
	2015		2014	
	Number of Accounts	Aggregated Outstanding Balances Upon Default	Number of Accounts	Aggregated Outstanding Balances Upon Default
Troubled debt restructurings that subsequently defaulted				
Credit card loans:				
Internal programs(1)(2)	3,023	$18	2,463	$15
External programs(1)(2)	1,591	$6	1,685	$7
Personal loans(2)	134	$1	97	$1
Private student loans(3)	279	$4	223	$3

	For the Six Months Ended June 30,			
	2015		2014	
	Number of Accounts	Aggregated Outstanding Balances Upon Default	Number of Accounts	Aggregated Outstanding Balances Upon Default
Troubled debt restructurings that subsequently defaulted				
Credit card loans				
Internal programs(1)(2)	6,199	$38	4,794	$29
External programs(1)(2)	3,234	$13	3,566	$15
Personal loans(2)	285	$3	203	$2
Private student loans(3)	584	$8	534	$8

(1) The outstanding balance upon default is the loan balance at the end of the month prior to default. Terms revert back to the pre-modification terms for customers who default from a temporary program and charging privileges remain revoked in most cases.
(2) A customer defaults from a modification program after two consecutive missed payments.
(3) Student loan defaults have been defined as loans that are 60 or more days delinquent.

Of the account balances that defaulted as shown above for the three months ended June 30, 2015 and 2014, approximately 45% and 39%, respectively, of the total balances were charged off at the end of the month in which they defaulted. Of the account balances that defaulted as shown above for the six months ended June 30, 2015 and 2014, approximately 44% and 36%, respectively, of the total balances were charged off at the end of the month in which they defaulted. For accounts that have defaulted from a loan modification program and have not been subsequently charged off, the balances are included in the allowance for loan loss analysis discussed above under "—Allowance for Loan Losses."

Purchased Credit-Impaired Loans

Purchased loans with evidence of credit deterioration since origination for which it is probable that not all contractually required payments will be collected are considered impaired at acquisition and are reported as PCI loans. The private student loans acquired in the SLC transaction, as well as the additional acquired private student loan portfolio comprise the Company’s only PCI loans at June 30, 2015 and December 31, 2014. Total PCI student loans had an outstanding balance of $3.6 billion and $3.9 billion, including accrued interest, and a related carrying amount of $3.4 billion and $3.7 billion as of June 30, 2015 and December 31, 2014, respectively.

Table of Contents

The following table provides changes in accretable yield for the acquired loans during each period (dollars in millions):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
Balance at beginning of period	$1,181	$1,512	$1,341	$1,580
Accretion into interest income	(57)	(66)	(116)	(134)
Other changes in expected cash flows	—	4	(101)	4
Balance at end of period	$1,124	$1,450	$1,124	$1,450

Periodically the Company updates the estimate of cash flows expected to be collected based on management's latest expectations of future credit losses, borrower prepayments and certain other assumptions that affect cash flows. No provision expense was recorded during the three and six months ended June 30, 2015 and 2014. The allowance for PCI loan losses at June 30, 2015 and December 31, 2014 was $28 million. For the three months ended June 30, 2015, there were no changes in other cash flow assumptions. For the six months ended June 30, 2015, the changes in expected cash flows from the decrease in accretable yield were primarily related to an increase in the borrower prepayment assumptions on certain pools. For the three and six months ended June 30, 2014, the changes in expected cash flows from the increase in accretable yield were primarily related to a decrease in the borrower prepayment assumptions on certain pools. Changes to accretable yield are recognized prospectively as an adjustment to yield over the remaining life of the pools.

At June 30, 2015, the 30 or more days delinquency and 90 or more days delinquency rates on PCI student loans (which include loans not yet in repayment) were 2.21% and 0.69%, respectively. At December 31, 2014, the 30 or more days delinquency and 90 or more days delinquency rates on PCI student loans (which include loans not yet in repayment) were 2.35% and 0.75%, respectively. These rates include private student loans that are greater than 120 days delinquent that are covered by an indemnification agreement or insurance arrangements through which the Company expects to recover a substantial portion of the loan. The net charge-off rate on PCI student loans was 0.38% and 0.50% for the three months ended June 30, 2015 and 2014, respectively, and 0.44% and 0.62% for the six months ended June 30, 2015 and 2014, respectively.

Mortgage Loans Held For Sale

The following table provides a summary of the initial unpaid principal balance of mortgage loans sold during each period, by type of loan (dollars in millions):

	For the Three Months Ended June 30,			
	2015		2014	
	Amount	%	Amount	%
Conforming[1]	$945	84.83 %	$572	90.51 %
FHA[2]	164	14.72	49	7.75
Jumbo[3]	—	—	11	1.74
VA[4]	5	0.45	—	—
Total	$1,114	100.00 %	$632	100.00 %

	For the Six Months Ended June 30,			
	2015		2014	
	Amount	%	Amount	%
Conforming[1]	$1,938	89.39 %	$1,019	90.26 %
FHA[2]	218	10.06	97	8.59
Jumbo[3]	6	0.28	13	1.15
VA[4]	6	0.27	—	—
Total	$2,168	100.00 %	$1,129	100.00 %

(1) Conforming loans are loans that conform to Government-Sponsored Enterprises guidelines.

(2) FHA loans are loans that are insured by the Federal Housing Administration and are typically made to borrowers with low down payments. The initial loan amount must be within certain limits.

(3) Jumbo loans are loans with an initial amount larger than the limits set by a Government-Sponsored Enterprise.

(4) VA loans are loans that are insured by and conform to the Department of Veteran Affairs guidelines.

Table of Contents

5. Credit Card and Student Loan Securitization Activities

Credit Card Securitization Activities

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

The DCENT debt structure consists of four classes of securities (DiscoverSeries Class A, B, C and D notes), with the most senior class generally receiving a triple-A rating. In this structure, in order to issue senior, higher rated classes of notes, it is necessary to obtain the appropriate amount of credit enhancement, generally through the issuance of junior, lower rated or more highly subordinated classes of notes, the majority of which are held by wholly-owned subsidiaries of Discover Bank. The credit-related risk of loss associated with trust assets as of the balance sheet date to which the Company is exposed through the retention of these subordinated interests is fully captured in the allowance for loan losses recorded by the Company.

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

Upon transfer of credit card loan receivables to the trust, the receivables and certain cash flows derived from them become restricted for use in meeting obligations to the trusts’ creditors. Further, the transferred credit card loan receivables are owned by the trust and are not available to third-party creditors of the Company. The trusts have ownership of cash balances that also have restrictions, the amounts of which are reported in restricted cash. Investment of trust cash balances is limited to investments that are permitted under the governing documents of the trusts and which have maturities no later than the related date on which funds must be made available for distribution to trust investors. With the exception of the seller’s interest in trust receivables, the Company’s interests in trust assets are generally subordinate to the interests of third-party investors and, as such, may not be realized by the Company if needed to absorb deficiencies in cash flows that are allocated to the investors in the trusts’ debt.

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

	June 30, 2015	December 31, 2014
Restricted cash	$667	$ 16
Investors’ interests held by third-party investors	15,900	15,950
Investors’ interests held by wholly-owned subsidiaries of Discover Bank	5,782	5,789
Seller’s interest	6,968	8,596
Loan receivables(1)	28,650	30,335
Allowance for loan losses allocated to securitized loan receivables(1)	(759)	(805)
Net loan receivables	27,891	29,530
Other	37	37
Carrying value of assets of consolidated variable interest entities	$28,595	$ 29,583

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

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

Insufficient cash flows would trigger the early repayment of the securities. This is referred to as the "economic early amortization" feature.

Investors are allocated cash flows derived from activities related to the accounts comprising the securitized pool of receivables, the amounts of which reflect finance charges billed, certain fee assessments, allocations of merchant discount and interchange, and recoveries on charged-off accounts. From these cash flows, investors are reimbursed for charge-offs

Table of Contents

occurring within the securitized pool of receivables and receive a contractual rate of return and Discover Bank is paid a servicing fee as servicer. Any cash flows remaining in excess of these requirements are reported to investors as excess spread. An excess spread rate of less than 0% for a contractually specified period, generally a three-month average, would trigger an economic early amortization event. In such an event, the Company would be required to seek immediate sources of replacement funding. Apart from the restricted assets related to securitization activities, the investors and the securitization trusts have no recourse to the Company’s other assets or the Company's general credit for a shortage in cash flows.

The Company is required to maintain a contractual minimum level of receivables in the trust in excess of the face value of outstanding investors’ interests. This excess is referred to as the minimum seller’s interest requirement. The required minimum seller’s interest in the pool of trust receivables, which is included in credit card loan receivables restricted for securitization investors, is set at approximately 7% in excess of the total investors’ interests (which includes interests held by third parties as well as those certificated interests held by the Company). If the level of receivables in the trust was to fall below the required minimum, the Company would be required to add receivables from the unrestricted pool of receivables, which would increase the amount of credit card loan receivables restricted for securitization investors. A decline in the amount of the excess seller’s interest could occur if balance repayments and charge-offs exceeded new lending on the securitized accounts or as a result of changes in total outstanding investors’ interests. Seller's interest is impacted by seasonality as higher balance repayments tend to occur in the first calendar year quarter. If the Company could not add enough receivables to satisfy the requirement, an early amortization (or repayment) of investors’ interests would be triggered. The Company retains significant exposure to the performance of trust assets through holdings of the seller's interest and subordinated security classes of DCENT and previously DCMT. In addition, the Company has the right to remove a random selection of accounts, which would serve to decrease the amount of credit card loan receivables restricted for securitization investors, subject to certain requirements including that the minimum seller's interest is still met.

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

In addition to performance measures associated with the transferred credit card loan receivables or the inability to add receivables to satisfy the seller's interest requirement, there are other events or conditions which could trigger an early amortization event, such as non-payment of principal at expected maturity. As of June 30, 2015, no economic or other early amortization events have occurred.

The table below provides information concerning investors’ interests and related excess spread (dollars in millions):

At June 30, 2015	Investors’ Interests[(1)]	# of Series Outstanding	3-Month Rolling Average Excess Spread	
Discover Card Execution Note Trust (DiscoverSeries notes)	$21,682	39	13.47	%

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

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

Student Loan Securitization Activities

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

Currently there are three trusts from which securities were issued to investors. Principal payments on the long-term secured borrowings are made as cash is collected on the underlying loans that are used as collateral on the secured borrowings. The Company does not have access to cash collected by the securitization trusts until cash is released in

Table of Contents

accordance with the trust indenture agreements and, for certain securitizations, no cash will be released to the Company until all outstanding trust borrowings have been repaid. Similar to the credit card securitizations, the Company continues to own and service the accounts that generate the student loan receivables held by the trusts and receives servicing fees from the trusts based on either a percentage of the principal balance outstanding or a flat fee per borrower. Although the servicing fee income offsets the fee expense related to the trusts and thus is eliminated in consolidation, failure to service the transferred loan receivables in accordance with contractual requirements could lead to a termination of the servicing rights and the loss of future servicing income, net of related expenses.

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

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

	June 30, 2015	December 31, 2014
Restricted cash	$82	$ 86
Student loan receivables[(1)]	1,820	1,969
Allowance for loan losses allocated to securitized loan receivables[(1)]	(28)	(28)
Net student loan receivables	1,792	1,941
Carrying value of assets of consolidated variable interest entities	$1,874	$ 2,027

(1) The Company maintains its allowance for loan losses on PCI loans sufficient to absorb probable decreases in cash flows that were previously expected. Therefore, credit risk associated with the transferred receivables is fully reflected on the Company's balance sheet in accordance with GAAP.

6. Deposits

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

The following table provides a summary of interest-bearing deposit accounts (dollars in millions):

	June 30, 2015	December 31, 2014
Certificates of deposit in amounts less than $100,000	$20,898	$ 21,502
Certificates of deposit in amounts $100,000 or greater[(1)]	5,479	5,634
Savings deposits, including money market deposit accounts	19,612	18,656
Total interest-bearing deposits	$45,989	$ 45,792

(1) Includes $1.1 billion and $1.2 billion in certificates of deposit greater than $250,000, the Federal Deposit Insurance Corporation ("FDIC") insurance limit, as of June 30, 2015 and December 31, 2014, respectively.

The following table summarizes certificates of deposit in amounts of $100,000 or greater by contractual maturity (dollars in millions):

Maturity Period	June 30, 2015
Three months or less	$908
Over three months through six months	824
Over six months through twelve months	1,160
Over twelve months	2,587

Total	$5,479

The following table summarizes certificates of deposit maturing over the remainder of this year, over each of the next four years, and thereafter (dollars in millions):

Year	June 30, 2015
2015	$6,263
2016	8,255
2017	4,449
2018	2,750
2019	1,732
Thereafter	2,928
Total	$26,377

7. Long-Term Borrowings

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

	June 30, 2015				December 31, 2014
	Maturity	Interest Rate	Weighted-Average Interest Rate	Outstanding Amount	Outstanding Amount
Securitized Debt					
Fixed-rate asset-backed securities(1)	2016-2020	0.69-5.65%	1.98%	$7,950	$8,950
Floating-rate asset-backed securities(2)(3)	2015-2019	0.37-0.77%	0.54%	7,949	7,000
Total Discover Card Master Trust I and Discover Card Execution Note Trust				15,899	15,950
Floating-rate asset-backed securities(4)(5)(6)(7)	2031-2042	0.45-4.25%	1.97%	1,291	1,445
Total SLC Private Student Loan Trusts				1,291	1,445
Total long-term borrowings - owed to securitization investors				17,190	17,395
Discover Financial Services (Parent Company)					
Fixed-rate senior notes(1)	2017-2025	3.75-10.25%	4.75%	2,069	1,558
Discover Bank					
Senior bank notes	2018-2026	2.00-4.25%	3.29%	4,142	2,892
Subordinated bank notes	2019-2020	7.00-8.70%	7.49%	698	698
Capital lease obligations(8)	2016	4.51%	4.51%	—	1
Total long-term borrowings				$24,099	$22,544

(1) The Company uses interest rate swaps to hedge portions of these long-term borrowings against changes in fair value attributable to changes in London Interbank Offered Rate ("LIBOR"). Use of these interest rate swaps impacts carrying value of the debt. As of June 30, 2015, there were no interest rate swaps outstanding for fixed-rate asset-backed securities. See Note 15: Derivatives and Hedging Activities.

(2) Discover Card Execution Note Trust floating-rate asset-backed securities include issuances with the following interest rate terms: 1-month LIBOR + 18 to 58 basis points and 3-month LIBOR + 20 basis points.

(3) The Company uses interest rate swaps to manage its exposure to changes in interest rates related to future cash flows resulting from interest payments on a portion of these long-term borrowings. There is no impact on debt carrying value from use of these interest rate swaps. See Note 15: Derivatives and Hedging Activities.

(4) SLC Private Student Loan Trusts floating-rate asset-backed securities include issuances with the following interest rate terms: 3-month LIBOR + 17 to 45 basis points, Prime rate + 75 to 100 basis points and 1-month LIBOR + 350 basis points.

(5) The Company acquired an interest rate swap related to the securitized debt assumed in the SLC transaction. The swap does not qualify for hedge accounting and has no impact on debt carrying value. See Note 15: Derivatives and Hedging Activities.

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

(7) Includes $330 million of senior notes maturing in 2031, $740 million of senior and subordinated notes maturing in 2036 and $221 million of senior notes maturing in 2042 as of June 30, 2015.

(8) As of June 30, 2015, the outstanding amount of capital lease obligations was not material.

Table of Contents

Maturities

Long-term borrowings had the following maturities (dollars in millions):

Year	June 30, 2015
Due in 2015	$1,500
Due in 2016	3,050
Due in 2017	5,106
Due in 2018	3,600
Due in 2019	3,278
Thereafter	7,565
Total	$24,099

The Company has access to committed undrawn capacity through private securitizations to support the funding of its credit card loan receivables. As of June 30, 2015, the total commitment of secured credit facilities through private providers was $7.8 billion, none of which had been used at June 30, 2015. Access to the unused portions of the secured credit facilities is subject to the terms of the agreements with each of the providers which have various expirations in 2016, 2017 and 2018. Borrowings outstanding under each facility bear interest at a margin above LIBOR or the asset-backed commercial paper costs of each individual conduit provider. The terms of each agreement provide for a commitment fee to be paid on the unused capacity and include various affirmative and negative covenants, including performance metrics and legal requirements similar to those required to issue any term securitization transaction.

8. Accumulated Other Comprehensive Income

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

	Unrealized Gain (Loss) on Available-for-Sale Investment Securities, Net of Tax	(Loss) Gain on Cash Flow Hedges, Net of Tax	Foreign Currency Translation Adjustments, Net of Tax[1]	Pension Plan Loss, Net of Tax	AOCI
For the Three Months Ended June 30, 2015					
Balance at March 31, 2015	$ 23	$(30)	$—	$(154)	$(161)
Net change	(10)	11	—	—	1
Balance at June 30, 2015	$ 13	$(19)	$—	$(154)	$(160)
For the Three Months Ended June 30, 2014					
Balance at March 31, 2014	$ 21	$9	$1	$(101)	$(70)
Net change	8	(10)	—	—	(2)
Balance at June 30, 2014	$ 29	$(1)	$1	$(101)	$(72)
For the Six Months Ended June 30, 2015					
Balance at December 31, 2014	$ 23	$(7)	$—	$(154)	$(138)
Net change	(10)	(12)	—	—	(22)
Balance at June 30, 2015	$ 13	$(19)	$—	$(154)	$(160)
For the Six Months Ended June 30, 2014					
Balance at December 31, 2013	$ 19	$13	$1	$(101)	$(68)
Net change	10	(14)	—	—	(4)
Balance at June 30, 2014	$ 29	$(1)	$1	$(101)	$(72)

(1) Includes unrealized gains/losses on hedge of net investment in foreign subsidiary, net of tax expense/benefit and net gains/losses on foreign currency translation adjustments.

Table of Contents

The table below presents each component of other comprehensive income (loss) ("OCI") before reclassifications and amounts reclassified from AOCI for each component of OCI before- and after-tax (dollars in millions):

	Before Tax	Tax Benefit (Expense)	Net of Tax
For the Three Months Ended June 30, 2015			