

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the year ended December 31, 2019

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

(State or other jurisdiction of incorporation or organization)

36-2517428

(I.R.S. Employer Identification No.)

2500 Lake Cook Road, Riverwoods, Illinois 60015

(Address of principal executive offices, including zip code)

(224) 405-0900

(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Trading Symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.01 per share	DFS	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** **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**

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** **No**

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). **Yes** **No**

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

Large Accelerated Filer	<input checked="" type="checkbox"/>	Accelerated Filer	<input type="checkbox"/>
Non-accelerated Filer	<input type="checkbox"/>	Smaller Reporting Company	<input type="checkbox"/>
		Emerging Growth Company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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 \$24,729,798,496.

As of February 21, 2020, there were 308,337,638 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 May 14, 2020 are incorporated by reference in Part III of this Form 10-K.

DISCOVER FINANCIAL SERVICES
Annual Report on Form 10-K for the year ended December 31, 2019

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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. See Item 8 — Financial Statements and Supplementary Data — Glossary of Acronyms for terms and abbreviations used throughout the annual report.

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® College Covered®, 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.

Part I.

Part I | Item 1. Business

Introduction

Discover Financial Services (the “Company”) is a direct banking and payment services company. We were incorporated in Delaware in 1960. We are 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 are subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the “Federal Reserve”). We provide direct banking products and services and payment services through our subsidiaries. We offer our customers credit card loans, private student loans, personal loans, home equity loans and deposit products. We had \$95.9 billion in loan receivables and \$54.4 billion in deposits issued through direct-to-consumer channels and affinity relationships at December 31, 2019. We also operate the Discover Network, the PULSE network (“PULSE”) and Diners Club International (“Diners Club”), collectively known as the Discover Global Network. The Discover Network processes transactions for Discover-branded credit and debit cards and 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 merchant acceptance 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.

Available Information

We make available, free of charge through the investor relations page of our internet site 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 our directors and executive officers, and any amendments to those documents filed with or furnished to the Securities and Exchange Commission (the “SEC”) pursuant to the Securities Exchange Act of 1934. These filings are available as soon as reasonably practicable after they are filed with or furnished to the SEC.

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

Operating Model

We manage our business activities in two segments: Direct Banking and Payment Services. Our Direct Banking segment includes consumer banking and lending products, specifically Discover-branded credit cards issued to individuals on the Discover Network and other consumer banking products and services, including student loans, personal loans, home equity loans and deposit products. Our Payment Services segment includes PULSE, Diners Club and our Network Partners business, which provides payment transaction processing and settlement services on the Discover Network.

We are principally engaged in providing products and services to customers in the United States; however, we also receive royalty and licensee revenue from sources outside of the United States from our Diners Club licensees and our Network Alliance partners. For quantitative information concerning our geographic distribution, see Note 4: Loan Receivables to our consolidated financial statements.

Below are descriptions of the principal products and services of each of our reportable segments. For additional financial information relating to our business and our operating segments, see Note 22: Segment Disclosures to our consolidated financial statements.

Direct Banking

Set forth below are descriptions of the credit cards, student loans, personal loans, home equity loans and deposit products issued by Discover Bank.

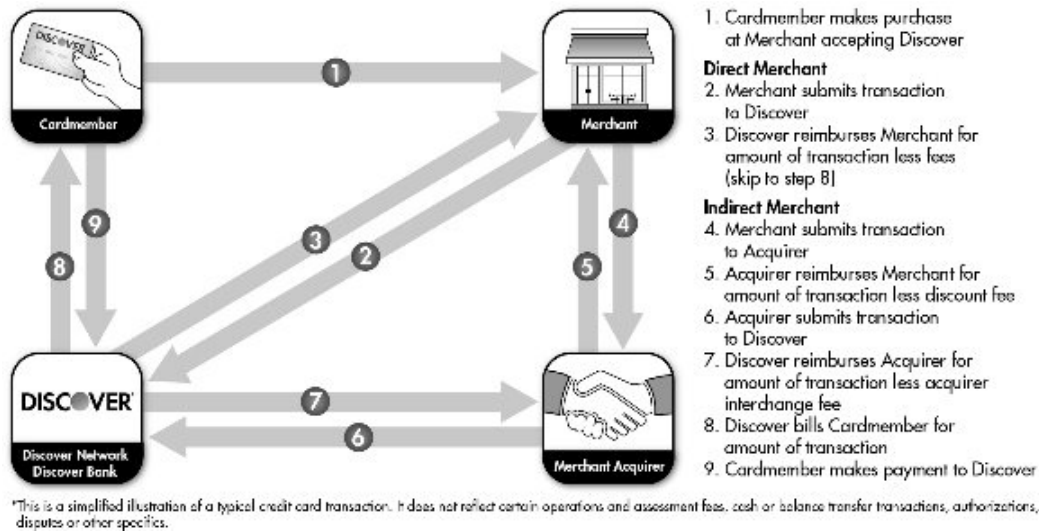
Credit Cards

We currently offer and issue credit cards to consumers. Our credit card customers are permitted to “revolve” their balances and repay their obligations over a period of time and at an interest rate set forth in their cardmember agreements, which may be either fixed or variable. The interest that we earn on revolving credit card balances makes up approximately 81% of our total interest income. We also charge customers other fees as specified in the cardmember agreements. These fees may include fees for late payments, returned checks, balance transfer transactions and cash advance transactions.

Our credit card customers’ transactions in the U.S. are processed over the Discover Network. We receive discount and fee revenue from merchants with whom we have a direct relationship. Where we do not have a direct relationship with a merchant, we receive acquirer interchange and assessment fees.

All of our cards offer rewards programs, the costs of which are generally recorded as a reduction of discount and interchange revenue. See “— Marketing — Rewards/Cashback Bonus” for further discussion of our programs offered.

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



For information on how we market our credit card loans, see “— Credit Risk Management — Account Acquisition (New Customers)” and “— Marketing.”

Student Loans

Our private student loans are primarily available to students attending eligible non-profit undergraduate and graduate schools. We also offer certain post-graduate loans, including consolidation, bar study and residency loans. All of our private student loans are unsecured and have terms and conditions that vary by product. We encourage students to borrow responsibly and maximize grants, scholarships and other free financial aid before taking student loans.

Our student loans feature fixed or variable interest rates with zero origination fees, and customers can elect to make extra payments to pay their loans off earlier than contractually scheduled without penalty. The loans can feature potential rewards, such as for good grades, and we also offer optional in-school payment products where students make monthly payments while in school. The standard repayment period is 15 to 20 years, depending on the type of student loan. Student loans may include a deferment period, during which interest continues to accrue and customers are not required to make payments while enrolled in school at least half time as determined by the school. This period begins on the date the loan is first disbursed and ends six to nine months (depending on loan type) after the customer ceases to be enrolled in school at least half time. As part of the loan approval process, all of our student loans, except for bar study,

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residency and private consolidation loans, are certified by and disbursed through the school to ensure students do not borrow more than the cost of attendance less other financial aid.

We market our student loans through digital channels, direct mail, email, radio and television. We also work with schools to create awareness of our products with students and their families. Students can apply for our student loans online, by telephone or by mail, and we have dedicated staff within our call centers to service student loans. We invite applicants who qualify to apply with a creditworthy cosigner, which may improve the likelihood of loan approval and a lower interest rate.

Personal Loans

Our personal loans are primarily intended to help customers consolidate existing debt, although they can be used for other purposes. These loans are unsecured with fixed interest rates, terms and payments, and have zero origination fees. The repayment period for personal loans is three to seven years and there is no prepayment penalty for repaying any portion of a personal loan balance prior to the scheduled maturity date. Customers may be subject to other charges, including late fees when a customer has not made a minimum payment by the contractual due date.

We generally market personal loans through direct mail, digital channels and email. Prospective applicants can obtain information regarding Discover Personal Loans online or by telephone and have the ability to apply online, by telephone or through the mail.

Home Equity Loans

Our home equity loans are intended for multiple purposes, including mortgage refinance, debt consolidation, home improvement and other major expenses. These loans are closed-end loans with fixed interest rates, terms and payments, and are secured by a first or second lien on a customer's home. These loans require monthly payment over a 10 to 30 year term. Customers may elect to make larger than minimum payments without being subject to a prepayment penalty, although certain third-party costs may be required to be reimbursed by the customer if the loan is repaid in full within three years. Customers may also be subject to additional charges, including late fees and returned payment charges.

We market home equity loans through a mix of direct mail, digital channels and email. Prospective applicants can obtain information and apply online or by telephone.

Deposits

We obtain deposits from consumers directly or through affinity relationships ("direct-to-consumer deposits"). Additionally, we obtain deposits through third-party securities brokerage firms that offer our deposits to their customers ("brokered deposits"). Our direct-to-consumer deposit products include online savings accounts, certificates of deposit, money market accounts, IRA certificates of deposit and checking accounts, while our brokered deposit products include certificates of deposit and sweep accounts. All of our deposits are insured by the Federal Deposit Insurance Corporation (the "FDIC") to the maximum permitted by law. We do not pay interest on checking account balances and instead offer cashback rewards for certain debit card purchases. Certificates of deposit are offered on a range of tenors from three months through ten years with interest rates that are fixed for the full period. There are minimum balance requirements to open certificates of deposit and penalties for early withdrawals. Money market accounts are savings accounts with minimum balance requirements. Money market accounts and savings accounts have limitations on withdrawal frequency, as required by law, and interest rates on these accounts are subject to change at any time. Service charges apply to some transactions and availability of funds varies based on product and method of funding.

We market our direct-to-consumer deposit products through the use of radio, print materials, direct mail, affinity arrangements with third parties and digital channels. Customers can generally apply for deposit accounts online or by telephone. Cashback checking account applications can only be initiated online. For more information regarding our deposit products, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Funding Sources — Deposits."

Payment Services

Set forth below are descriptions of PULSE, Diners Club and our Network Partners business, which provides, among other services, payment transaction processing and settlement services.

PULSE

Our PULSE network is one of the nation's leading debit/ATM networks. PULSE links cardholders served by financial institutions to ATMs and point-of-sale ("POS") terminals located throughout the United States, including cardholders at financial institutions with which PULSE has direct relationships and through agreements PULSE has with other debit networks. PULSE also provides cash access at ATMs internationally.

PULSE's primary source of revenue is transaction fees charged for switching and settling ATM and 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 transaction processing, debit card fraud detection and risk mitigation services, 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 are eligible to be used at all of the ATMs and POS debit terminals that participate in the PULSE network, and the PULSE mark can be used on that institution's debit cards and ATMs. In addition, financial institution participants may sponsor merchants, direct processors and independent sales organizations to participate in the PULSE 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.

When PULSE enters into a network-to-network agreement with another debit network, the other network's participating financial institutions' debit cards can be used at terminals in the PULSE network. PULSE does not have a direct relationship with these financial institutions and the other network bears the financial responsibility for transactions of those financial institutions' cardholders and for ensuring compliance with PULSE's operating rules.

Diners Club

Our Diners Club business maintains a global acceptance network through its relationships with licensees, which are generally financial institutions. We do not directly issue Diners Club cards to consumers, but grant our licensees the right to issue Diners Club branded 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. We also earn revenue from providing various support services to our Diners Club licensees, including processing and settlement of cross-border transactions. We also provide a centralized service center and technological services to our licensees.

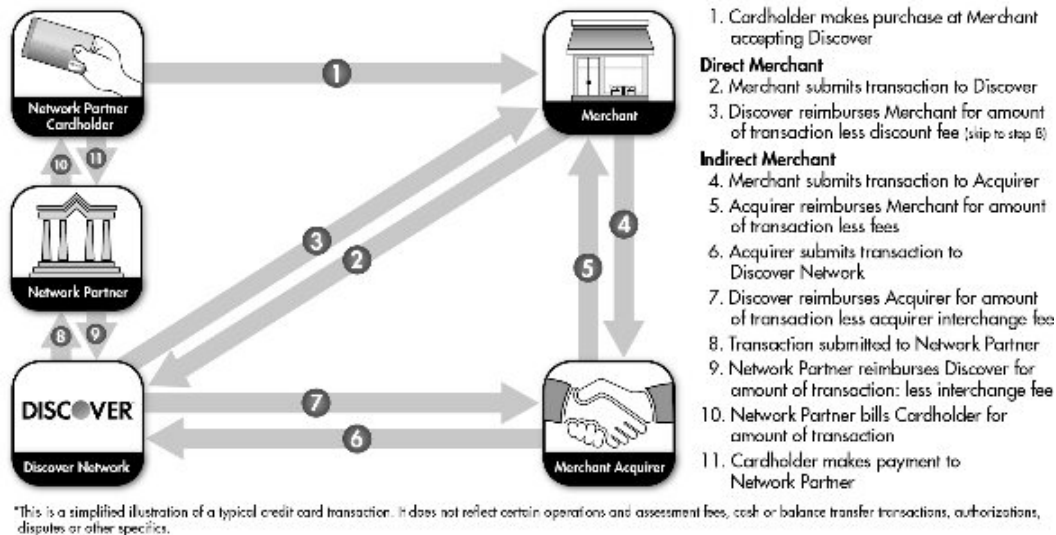
When Diners Club cardholders use their cards outside the host country or territory of the issuing licensee, transactions are routed and settled over the Diners Club network through its centralized service center. In order to increase merchant acceptance in certain targeted countries and territories,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

Network Partners Business

We have agreements with a number of financial institutions, networks or network alliances, and commercial service providers for issuance of products or processing of payments on the Discover Global Network (i.e. Discover Network, PULSE and Diners Club). We refer to these financial institutions, networks and commercial service providers as "Network Partners." We may earn merchant discount and acquirer assessments net of issuer fees paid, in addition to other fees, for processing transactions for Network Partners. We also leverage our payments infrastructure in other ways, such as business-to-business payment processing.

Our Network Partners business is comprised of network-to-network partners ("Network Alliances"), technology-enabled partners and our commercial payments network. Network Alliances allow Discover-enabled cards to be used at other networks' participating merchants and allow other networks' participating issuers' cards to be used at Discover Network merchants. Our commercial payments network facilitates transactions and business-to-business payments between buyers and suppliers using the existing payment infrastructure of Discover Network.

The following chart* shows an example of a Network Partners transaction cycle:



* * *

The discussion below provides additional detail concerning the supporting functions of our two segments. The credit card, student loan, personal loan, home equity loan and deposit products issued through our Direct Banking segment require significant investments in consumer portfolio risk management, marketing, customer service and related technology, whereas the operation of our Payment Services business requires that we invest in the technology to manage risk and service network partners, merchants and merchant acquirer relationships.

Credit Risk Management

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

Account Acquisition (New Customers)

We acquire new credit card customers through direct mail, internet, media advertising, merchant or partner relationships, or through unsolicited individual applications. We also acquire new student loan, personal loan and home equity loan customers through similar channels. In all cases we have a rigorous process for screening applicants.

To identify credit-worthy prospective customers, our credit risk management and marketing teams use proprietary analytical tools to match our product offerings with customer needs. We consider the prospective customer’s financial stability, as well as ability and willingness to pay.

We assess the creditworthiness of each consumer loan applicant through evaluating an applicant’s credit information provided by credit bureaus and information from other sources. The assessment is performed using our credit scoring systems, both externally developed and proprietary. For our unsecured lending products, we also use experienced credit underwriters to supplement our automated decision-making processes. For our home equity products, experienced credit underwriters must review and approve each application.

Upon approval of a customer’s application for one of our lending products, we assign a specific annual percentage rate using an analytically driven pricing framework that simultaneously provides competitive pricing for customers and seeks to maximize revenue on a risk-adjusted basis. For our credit card loans, we also assign a credit line based on risk level and expected return.

Portfolio Management (Existing Customers)

The revolving nature of our credit card loans requires that we regularly assess the credit risk exposure of such accounts. This assessment uses the individual's Discover account performance information as well as information from credit bureaus. We utilize 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 transaction authorization limits and increases or decreases on credit limits.

Customer Assistance

We provide our customers with a variety of tools to proactively manage their accounts, including email, text message and push reminders and a website dedicated to customer education, as further discussed under the heading "— Customer Service." These tools are designed to limit a customer's risk of becoming delinquent. When a customer's account becomes delinquent or is at risk of becoming delinquent, we employ a variety of strategies to assist customers in returning to current status on their accounts.

All monthly billing statements of accounts with past due amounts include a request for payment of such amounts. Customer assistance personnel generally initiate contact with customers within 30 days after any portion of their balance becomes past due. The nature and the timing of the initial contact are determined by a review of the customer's prior account activity and payment habits.

We reevaluate our collection efforts, and consider the implementation of other techniques, as a customer becomes increasingly delinquent. We limit our exposure to delinquencies through controls within our process for authorizing transactions and credit limits 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 interest rates and/or waive fees to aid customers in returning to current status on their obligations to us. For more information see Note 4: Loan Receivables to our consolidated financial statements.

Marketing

Our marketing group works closely with credit risk management to provide key functions, including product development, management of our Cashback Bonus and other rewards programs, protection product management, and brand and advertising management, to acquire new customers and enhance our relationships with existing customers.

Product Development

In order to attract and retain customers and merchants, we continue to develop new programs, features and benefits and market them through a variety of channels, including television, radio, mail and digital. Marketing efforts may promote no annual fee, Cashback Bonus, FICO Credit Score for free, Freeze it, Social Security Number Alerts, New Account Alerts, balance transfer offers and other rewards programs. Through the development of a large prospect database, use of credit bureau data and use of a customer contact strategy and management system, we continuously develop our modeling and customer engagement capabilities, which helps optimize product, pricing and channel selection.

Rewards / Cashback Bonus

Our cardmembers use several card products, all with no annual fee, that allow them to earn their rewards based on their spend, which can be redeemed in any amount at any time, in general as set forth below.

- *Discover it* card offers 5% Cashback Bonus in categories that change each quarter up to a quarterly maximum and 1% Cashback Bonus on all other purchases.
- *Discover it Chrome* card offers 2% Cashback Bonus at gas stations and restaurants on up to \$1,000 in combined purchases each quarter and 1% Cashback Bonus on all other purchases.
- *Discover it Miles* card offers 1.5 miles for every dollar spent on purchases.
- *Discover it Business* card offers 1.5% Cashback Bonus on all purchases.

- *Discover More* card, which we no longer offer for new accounts, offers 5% Cashback Bonus in categories that change each quarter up to a quarterly maximum. Customers earn .25% Cashback Bonus on their first \$3,000 on all other annual purchases and on all warehouse purchases, and 1% Cashback Bonus on purchases over \$3,000.

Protection Products

We currently sell an identity theft protection product, and we service and maintain existing enrollments of the payment and wallet protection products detailed below for our credit card customers.

- *Identity Theft Protection.* The identity theft monitoring product includes an initial credit report, credit bureau report monitoring at the three major credit bureaus, prompt alerts to key changes to credit bureau files that help customers spot possible identity theft quickly, internet surveillance to monitor multiple credit and debit card numbers and social security numbers on suspicious websites, identity theft insurance of \$1,000,000 to cover certain out-of-pocket expenses due to identity theft, and access to knowledgeable professionals who can help resolve issues.
- *Payment Protection.* This product allows customers to suspend their minimum payments due for up to two years, depending on the qualifying event and product level, when certain qualifying life events occur. While on benefit, customers have no minimum monthly payment, and are not charged interest, late fees or the fees for the product. This product covers a variety of different events, such as unemployment, disability, natural disasters or other life events, such as marriage or birth of a child. Depending on the product level and availability under state laws, outstanding balances up to \$10,000 or \$25,000, are cancelled in the event of death.
- *Wallet Protection.* This product offers one-call convenience if a 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 at the three major credit bureaus for 180 days and alerting them to key changes to their credit files, and providing up to \$100 to replace the customer's wallet or purse.

Brand and Advertising Management

We maintain a full-service marketing department charged with delivering integrated mass and direct communications to foster customer engagement with our products and services. We also leverage strategic partnerships and sponsorship properties such as the NHL and the Big Ten Conference to help drive loan growth. Our brand team utilizes consumer insights and market intelligence to define our mass communication strategy, create multi-channel advertising messages and develop marketing partnerships with sponsorship properties. This work is performed in house as well as with a variety of external agencies and vendors.

Customer Service

Our credit card customers have the option to manage their accounts online via Discover.com, through Discover Mobile applications and by calling our U.S.-based customer service personnel. Our digital solutions offer a range of benefits, which may include:

- Access to overall credit health tools such as Credit Scorecard, Freeze it, Social Security Number Alerts and New Account Alerts;
- Customer service via multiple communication channels, including 24/7 customer service by telephone and messaging; and
- Proactive notifications via email, text messaging and in-app messaging for monitoring transaction activity and account security.

Our student loan, personal loan, home equity loan and deposit product customers can utilize our online account services to manage their accounts and to use interactive tools and calculators.

Processing Services

Our processing services cover four functional areas: card personalization, print/mail, remittance processing and document processing. Card personalization is responsible for the mailing of credit and debit cards for new accounts, replacements and reissues. Print/mail specializes in statement and letter printing and mailing. Remittance processing

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handles account payments and check processing. Document processing handles hard-copy forms, including new account applications submitted through the mail.

Fraud Prevention

We monitor our customers' accounts to help 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 monitor the authorization of application information, verification of customer identity, sales, processing of convenience and balance transfer checks, and electronic transactions.

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

Discover Network Operations

We support our merchants through a merchant acquiring model that includes direct relationships with large merchants in the United States and arrangements with merchant acquirers generally for small- and mid-size merchants. In addition to our U.S.-based merchant acceptance locations, Discover Network cards are accepted in a growing number of countries around the world on the Diners Club network, or through reciprocal acceptance arrangements made with international payment networks (i.e., Network Alliances).

We maintain direct relationships with most of our large merchant accounts, which enables us to benefit from joint marketing programs and opportunities and to retain the entire discount revenue from the merchants. The terms of our direct merchant relationships are governed by merchant services agreements. These agreements are also accompanied by additional program documents that further define our network functionality and requirements, including operating regulations, technical specifications and dispute rules. To enable ongoing improvements in our network's functionality and in accordance with industry convention, we publish updates to our program documents on a semi-annual basis.

Discover Network services the majority of its small- and mid-size merchant portfolios through third-party merchant acquirers to allow such acquirers to offer a comprehensive payments processing package to such merchants. Merchants also can apply to our merchant acquirer partners directly to accept Discover Network cards through the acquirers' integrated payments solutions. Merchant acquirers provide merchants with consolidated servicing for Discover, Visa and MasterCard transactions, resulting in streamlined statements and customer service for 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 ensure data integrity, prevent fraud and ensure compliance with our operating regulations. Our systems evaluate incoming transaction activity to identify abnormalities that require investigation and fraud mitigation. Designated Discover Network personnel are responsible for validating compliance with our operating regulations and law, including enforcing our data security standards and prohibitions against illegal or otherwise unacceptable activities. Discover Network is a founding and current member of the Payment Card Industry Security Standards Council, LLC (the "Council") and is working to expand the adoption of the Council's security standards globally for merchants and service providers that store, transmit or process cardholder data.

Technology

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

Our approach to technology development and management involves both third-party and in-house resources. We use third-party vendors for basic technology services (e.g., cloud, telecommunications, hardware and operating systems) as well as for processing and other services for our direct banking and payment services businesses. We subject each vendor to a formal approval process, which includes among other things a security assessment, to ensure that the vendor can assist us in maintaining a cost-effective and reliable technology platform. We use our in-house resources to build, maintain and oversee some of our technology systems. We believe this approach enhances our operations and improves cost efficiencies.

Seasonality

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

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

Competition

We compete with other consumer financial services providers, including non-traditional providers such as financial technology firms and payment networks on the basis of a number of factors, including brand, reputation, customer service, product and service offerings, incentives, pricing and other terms. Our credit card business also competes on the basis of reward programs and merchant acceptance. We compete for accounts and utilization with cards issued by other financial institutions (including American Express, Bank of America, JPMorgan Chase, Capital One and Citi) and, to a lesser extent, businesses that issue their own private label cards or otherwise extend credit to their customers. In comparison to our largest credit card competitors, our strengths include cash rewards, conservative portfolio management and strong customer service. Competition based on rewards and other card features and benefits continues to be strong. Our student loan product competes for customers with Sallie Mae and Wells Fargo, as well as other lenders that offer private student loans. Our personal loan product competes for customers primarily with Citi, Wells Fargo, Goldman Sachs and non-traditional lenders, including financial technology firms and peer to peer lenders. Our home equity loan product faces competition primarily from traditional branch lending institutions and credit unions, as well as providers of cash-out refinance loans and home equity lines of credit.

Although our student and personal loan receivables have increased, our credit card receivables continue to represent a majority of our receivables. The credit card business is highly competitive. Some of our competitors offer a wider variety of financial products than we do, which may currently position them better among customers who prefer to use a single financial institution to meet all of their financial needs. Some of our competitors enjoy greater financial resources, diversification and scale than we do, and are therefore able to invest more in initiatives and technology to attract and retain customers, such as advertising, targeted marketing, account acquisitions and pricing offerings in interest rates, annual fees, reward programs and low-priced balance transfer programs. In addition, some of our competitors have assets such as branch locations and co-brand relationships that may help them compete more effectively. Another competitive factor in the credit card business is the increasing use of debit cards as an alternative to credit cards for purchases.

Because most domestically-issued credit cards, other than those issued on the American Express network, are issued on the Visa and MasterCard networks, most other card issuers benefit from the dominant market share of Visa and MasterCard. The former exclusionary rules of Visa and MasterCard limited our ability to attract merchants and credit and debit card issuers, contributing to Discover not being as widely accepted in the U.S. as Visa and MasterCard. Merchant acceptance of the Discover card has increased in the past several years, both in the number of merchants enabled for acceptance and the number of merchants actively accepting Discover. We continue to make investments in expanding Discover and Diners Club acceptance in key international markets where an acceptance gap exists.

In our payment services business, we compete with other networks for volume and to attract network partners to issue credit, debit and prepaid cards on the Discover, PULSE and Diners Club networks. We generally compete on the basis of customization of services and various pricing strategies, including incentives and rebates. We also compete on

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the basis of issuer fees, fees paid to networks (including switch fees), merchant acceptance, network functionality, customer perception of service quality, brand image, reputation and market share. The Diners Club and Discover networks' primary competitors are Visa, MasterCard and American Express, and PULSE's network competitors include Visa's Interlink, MasterCard's Maestro and First Data's STAR. American Express is a particularly strong competitor to Diners Club as both cards target international business travelers. As the payments industry continues to evolve, we are also facing increasing competition from financial technology firms and alternative payment solutions, which leverage new technologies and a customer's existing deposit and credit card accounts and bank relationships to create payment or other fee-based solutions.

In our direct-to-consumer deposits business, we have acquisition and servicing capabilities similar to other large direct banks, including Ally, American Express, Barclays, Capital One (360), Goldman Sachs, Synchrony and USAA. We compete with traditional banks and credit unions that source deposits through branch locations and direct channels. We seek to differentiate our deposit product offerings on the basis of brand reputation, digital experience, customer service and value.

For more information regarding the nature of and the risks we face in connection with the competitive environment for our products and services, see "Risk Factors — Strategic Business Risk."

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 December 31, 2019, we employed approximately 17,200 individuals.

Risk Management

Our business exposes us to strategic, credit, market, liquidity, operational, compliance and legal risks. We use an enterprise-wide risk management framework to identify, measure, monitor, manage and report risks that affect or could affect the achievement of our strategic, financial and other objectives.

Enterprise Risk Management Principles

Our enterprise risk management philosophy is expressed through five key principles that guide our approach to risk management: Comprehensiveness, Accountability, Independence, Defined Risk Appetite and Transparency.

Comprehensiveness

We seek to maintain a comprehensive risk management framework for managing risk enterprise-wide, including policies, risk management processes, monitoring and testing, and reporting. Our framework is designed to be comprehensive with respect to our business units and their control and support functions, and across all risk types.

Accountability

We structure accountability across three lines of defense along the principles of risk management execution, oversight and independent validation. As the first line of defense, our business units seek to manage the risks to which they are exposed as a result of their activities, including those risks arising from activities that have been outsourced to third parties. The principles apply across all businesses and risk types and guide the definition of specific roles and responsibilities.

Independence

Our second and third lines of defense, which are comprised of risk and control functions, operate independent of the business units. The second line of defense includes our corporate risk management ("CRM") department, which is led by our Chief Risk Officer ("CRO"), who is appointed by our Board of Directors. The CRM department sets risk management standards and policies that are designed to be consistent with the size and complexity of our business, industry practices and applicable legal and regulatory requirements. The CRO is accountable for providing our Board

of Directors and executive management with 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 risks across the enterprise. Our internal audit department, as the third line of defense, performs periodic, independent reviews and tests compliance with risk management policies, procedures and standards across the Company. It also periodically reviews the design and operating effectiveness of our risk management program and processes, including the independence and effectiveness of our CRM function, and reports the results to our Audit Committee of the Board of the Directors (“Audit Committee”) and, where appropriate, the Risk Oversight Committee of the Board of Directors (“Risk Oversight Committee”).

Defined Risk Appetite

We operate within a risk appetite framework approved by our Board of Directors, which guides an acceptable level of risk-taking, considering desired financial returns and other objectives. To that end, limits and escalation thresholds are set consistent with the risk appetite approved by our Board of Directors.

Transparency

We seek to provide transparency of exposures and outcomes, which is core to our risk culture. We provide this risk transparency through our risk committee structure and standardized processes for escalating issues and reporting. This is accomplished at several levels within the organization, including quarterly meetings held by our Risk Committee and quarterly reports to the Risk Oversight Committee and Audit Committee, as well as regular reporting to our Risk subcommittees commensurate with the needs of our businesses. Further, our CRO is a member of the Company’s Executive Committee.

Enterprise Risk Management Governance Structure

Our governance structure is based on the principle that each line of business is responsible for managing risks inherent in its business with appropriate oversight from our senior management and Board of Directors. Various committees are in place to oversee the management of risks across our Company. We seek to apply operating principles consistently to each committee. These operating principles are detailed in committee charters, which are approved by the Risk Committee. Our banking subsidiaries have their own risk governance, compliance, auditing and other requirements. Our risk governance framework is designed such that bank-level risk governance requirements are satisfied as well.

Board of Directors

Our Board of Directors (i) approves certain risk management policies, (ii) approves our capital targets and goals, (iii) approves our risk appetite framework, (iv) monitors our strategic plan, (v) appoints our CRO and other risk governance function leaders, as appropriate, (vi) receives reports on any exceptions to the Enterprise Risk Management policy and (vii) receives and reviews regulatory examination reports. The Board of Directors receives reports from the Audit Committee and Risk Oversight Committee on risk management matters and from the Compensation and Leadership Development Committee on risks associated with compensation and leadership development.

Risk Oversight Committee of our Board of Directors

Our Risk Oversight Committee is responsible for overseeing our risk management policies and the operations of our enterprise-wide risk management framework and our capital planning, liquidity risk management and resolution planning activities. The Committee is responsible for (i) approving and periodically reviewing our risk management policies, (ii) overseeing the operation of our policies and procedures for establishing our risk management governance, risk management procedures and risk-control infrastructure, (iii) overseeing the operation of processes and systems for implementing and monitoring compliance with such policies and procedures, (iv) reviewing and making recommendations to the Board of Directors, as appropriate, regarding the Company’s risk management framework, key risk management policies and the Company’s risk appetite and tolerance, (v) receiving and reviewing regular reports from our CRO on risk management deficiencies and emerging risks, the status of and changes to risk exposures, policies, procedures and practices, and the steps management has taken to monitor and control risk exposures, (vi) receiving reports on compliance with our risk appetite and limit structure and risk management policies, procedures and controls, (vii) overseeing capital planning, liquidity risk management and resolution planning related activities, and (viii) sharing information, liaising and meeting in joint session with the Audit Committee (which it may do through the Chairs of the Committees) as necessary or desirable to help ensure that the committees have received the information necessary to permit them to fulfill their duties and responsibilities with respect to oversight of risk management matters.

Audit Committee of our Board of Directors

With respect to the enterprise risk management framework, our Audit Committee is responsible for the following: (i) discussing policies with respect to risk assessment and management, (ii) receiving and reviewing reports from our CRO and other members of management as the Committee deems appropriate on the guidelines and policies for assessing and managing our exposure to risks, the corporation's major financial risk exposures and the steps management has taken to monitor and control such exposures, and (iii) sharing information and liaising with the Risk Oversight Committee as necessary or desirable to help ensure that the committees have received the information necessary to permit them to fulfill their duties and responsibilities with respect to oversight of risk management matters.

Compensation and Leadership Development Committee of our Board of Directors

Our Compensation and Leadership Development Committee is responsible for overseeing risk management associated with the Company's compensation and leadership development practices. The Committee receives reporting regarding the Company's compensation practices and evaluates whether these practices encourage excessive risk-taking. As a part of its reviews, the Committee considers input from our CRO and takes into account risk outcomes. The Compensation and Leadership Development Committee receives reporting regarding talent management practices and evaluates risks associated with leadership development and succession planning.

Risk Committee

Our Risk Committee is an executive management-level committee that establishes a comprehensive enterprise risk management program, which includes (i) providing a regular forum for representatives of our different functional groups to identify and discuss key risk issues and to recommend to senior management actions that should be taken to manage the level of risk taken by the business lines, (ii) establishing and overseeing an enterprise-wide approach to risk management through the development of our Enterprise Risk Management Policy and the associated oversight framework for the identification, measurement, monitoring, management and reporting of enterprise risk, (iii) communicating our risk appetite and philosophy, including establishing limits and thresholds for managing enterprise-wide risks, and (iv) reviewing, on a periodic basis, our aggregate enterprise-wide risk exposures and the effectiveness of risk identification, measurement, monitoring, management and reporting policies and procedures, and related controls within the lines of business.

Our Risk Committee has formed and designated a number of committees to assist it in carrying out its responsibilities. These committees, made up of representatives from senior levels of management, escalate issues to our Risk Committee as guided by escalation thresholds. These risk management committees include the Discover Bank Credit Committee, Asset/Liability Management Committees (Discover Financial Services and Discover Bank), the Counterparty Credit Committee, the New Initiatives Committee, the Operational Risk Committee, the Capital Planning Committee, the Compliance Committee, the Information Security Executive Committee and the Human Resources Risk Committee.

Chief Executive Officer

The Chief Executive Officer ("CEO") is ultimately responsible for risk management within our Company. In that capacity, the CEO establishes a risk management culture throughout the Company and ensures that businesses operate in accordance with this risk culture.

Business Unit Heads

Our business unit heads are responsible for managing risk associated with pursuit of their strategic, financial and other business objectives. Business unit heads are responsible for (i) complying with all risk limits and risk policies, (ii) identifying risks and implementing appropriate controls, (iii) explicitly considering risk when developing strategic plans, budgets and new products, (iv) implementing appropriate controls when pursuing business strategies and objectives, (v) ensuring business units implement business unit processes, controls and monitoring to support corporate model risk management standards such as documentation standards and reporting standards, (vi) coordinating with CRM to produce relevant, sufficient, accurate and timely risk reporting that is consistent with the processes and methodology established by CRM, (vii) ensuring sufficient financial resources and qualified personnel are deployed to control the risks inherent in the business activities, and (viii) designating, in consultation with the CRO, a Business Risk Officer to assist with the above and to perform the specific duties described below.

Business Risk Officers work in conjunction with the business unit head to implement a business risk management program that satisfies business unit needs and adheres to corporate policy, standards and risk architecture.

Chief Risk Officer

As a member of the Company's senior management team, the CRO chairs our Risk Committee. In addition, the CRO has oversight responsibility to establish the CRM function with capabilities to exercise its mandate across all risk categories. Our CRO reports directly to our Risk Oversight Committee and administratively to the CEO. Our CRO provides an independent view on the key risks to which our Company is exposed to our Risk Committee, our Audit Committee, our Risk Oversight Committee and our Board of Directors.

Corporate Risk Management

The CRM department is led by the CRO and supports business units by providing objective oversight of our risk profile to help ensure that risks are managed, aggregated and reported to our Risk Committee, our Risk Oversight Committee and our Audit Committee. The CRM department participates in our Risk Committee and sub-committee meetings to provide an enterprise-wide perspective on risk, governance matters, policies and risk thresholds. The CRM department is comprised of enterprise, operational, consumer credit, counterparty credit, market, liquidity, compliance, Bank Secrecy Act/anti-money laundering, third-party, business technology, model, information security and insurance risk functions, each of which manages the risks associated with their respective area.

Credit Risk Management

Credit Risk Management is responsible for (i) developing, validating and implementing credit policy criteria and predictive loan origination and servicing models in order to optimize the profitability of Company lending activities, (ii) ensuring adherence to our credit risk policies and approval limits, and that departmental policies, procedures, and internal controls are consistent with the standards defined by the Company, (iii) ensuring that we manage credit risk within approved limits, and (iv) monitoring performance for both new and existing consumer loan products and portfolios.

Law Department

The law department plays a significant role in managing our legal risk by, among other things, identifying, interpreting and advising on legal and regulatory risks. The CRM department collaborates and coordinates closely with other risk and control functions in exercising its oversight responsibilities, in particular with the law department. Our law department participates in meetings of the Risk Committee and the sub-committees of the Risk Committee in order to advise on legal risks and to inform the committees of any relevant legislative and regulatory developments.

Internal Audit Department

Our internal audit department performs periodic, independent reviews and testing of compliance with risk management policies and standards across the Company, as well as assessments of the design and operating effectiveness of these policies and standards. The internal audit department also validates that risk management controls are functioning as intended by reviewing and evaluating the design and operating effectiveness of the CRM program and processes, including the independence and effectiveness of the CRM function. The results of such reviews are reported to our Audit Committee.

Risk Categories

We are exposed to a broad set of risks in the course of our business activities due to both internal and external factors, which we segment into six major risk categories. The first five are defined to be broadly consistent with guidance published by the Federal Reserve and the Basel Committee on Banking Supervision ("BCBS"): credit, market, liquidity, operational, compliance and legal risk. We recognize the sixth, strategic risk, as a separate risk category. We evaluate the potential impact of a risk event on the Company by assessing the financial impact, the impact to our reputation, the legal and regulatory impact, and the client/customer impact. In addition, we have established various policies to help govern these risks.

Credit Risk

Our 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 Discover Bank through the issuance of (i) unsecured credit including credit cards, student loans and personal loans and (ii) secured credit including deposit secured credit cards and home equity loans. Counterparty credit risk is incurred

through a number of activities including settlement, certain marketing programs, treasury and asset/liability management, network incentive programs, guarantors, vendor relationships and insurers.

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. Given the nature of our business activities, we are exposed to various types of market risk; in particular interest rate risk, foreign exchange risk and other risks that arise through the management of our investment portfolio. Interest rate risk is more significant relative to other market risk exposures and results from potential mismatches in the repricing term of assets and liabilities (yield curve risk) and volatility in reference rates used to reprice floating-rate structures (basis risk). Foreign exchange risk is primarily incurred through exposure to currency movements across a variety of business activities and is derived, specifically, from the timing differences between transaction authorizations and settlement.

Liquidity Risk

Liquidity risk is the risk that we will be unable to meet our obligations as they become due because of an inability to liquidate assets or obtain adequate funding, or an inability to easily unwind or offset specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions.

Operational Risk

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk is inherent in all our businesses. Operational risk categories incorporate all of the operational loss event-type categories set forth by the BCBS, which include the following: (i) internal fraud, (ii) external fraud, (iii) employment practices and workplace safety, (iv) clients, products and business practices, (v) damage to physical assets, (vi) business disruption and system failures, and (vii) execution, delivery and process management.

Compliance 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. Compliance risk exposures are actively and primarily managed by our business units in conjunction with our compliance department. Our compliance program governs the management of compliance risk and includes oversight by our Risk Committee and Compliance Committee.

Legal Risk

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. Legal risk exposures are primarily managed by our business units in conjunction with our law department. Our Risk Committee and Compliance Committee oversee our legal risk management. Specifically, the law department is responsible for providing advice, interpreting and identifying developments regarding laws, regulations, regulatory guidance and litigation, and setting standards for communicating relevant changes to corporate compliance, the business and internal audit. The law department also identifies and communicates legal risk associated with new products and business practices.

Strategic Risk

Strategic risk is the risk that our strategies and the execution of those strategies do not produce the desired outcome, resulting in a negative impact on our enterprise value. This risk can be driven by internal and external factors, including (i) our business model, market position, selection of strategies and execution of those strategies and (ii) competitor strategies, emergence of new competitors, emergence of new technologies, changing consumer preferences or other market factors.

Our Risk 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 on and are accountable for managing strategic risk in pursuit of their objectives.

Enterprise Risk Management Framework

Our enterprise risk management principles are executed through a risk management framework that is based upon industry standards for managing risk and controls. While the detailed activities vary by risk type, there are common process elements that apply across risk types. We seek to apply these elements consistently in the interest of effective and efficient risk management. This framework seeks to link risk processes and infrastructure with the appropriate risk oversight to create a risk management structure that raises risk awareness, reduces impact of potential risk events, improves business decision-making and increases operational efficiency.

Risk Identification

We seek to identify potential exposures that could adversely affect our ability to successfully implement strategies and achieve objectives. To ensure that the full scale and scope of risk exposures from firm-wide activities are identified, we seek to identify risk exposures based on (i) significant enterprise-level risks that are strategic, systemic, or emerging in nature, (ii) granular risk exposures from on-balance sheet and off-balance sheet positions, including concentrations, and (iii) risk exposures from initiatives focused on new, expanded, customized, or modified products, services, and processes.

Risk exposures identified through these three approaches are consolidated to create a comprehensive risk inventory. This inventory is leveraged by a number of processes within the Company including stress scenario design and stress testing, capital planning, risk appetite setting and risk modeling. The risk inventory is reviewed and approved at least annually by the Risk Committee while the sub-committees review the risks mapped to the relevant risk categories for transparency and comprehensive coverage of risk exposures.

Risk Measurement

Our risk measurement process seeks to ensure that the identified risk exposures are appropriately assessed. Risk measurement techniques appropriate to the risk category, including econometric modeling, statistical analysis, peer benchmarking and qualitative assessments, are employed to measure our material risk exposures.

Risk Monitoring

Our risks are monitored through an integrated monitoring framework consisting of risk appetite metrics and key risk indicators (“KRIs”). These metrics are established to monitor changes in our risk exposures and external environment. Risk appetite metrics are used to monitor the overall risk profile of the Company by setting risk boundaries and expectations through quantitative limits and qualitative expressions. We use KRIs to monitor our risk profile through direct or indirect alignment with the risk appetite limits.

These metrics enable monitoring of risk by business management and by measuring risk and performance data against risk appetite and KRI escalation thresholds that are updated periodically. Escalation procedures are in place to notify the appropriate governance committees in the event of any actual risk limit breaches or potential upcoming breaches.

Risk Management

We have policies and a defined governance structure in place to manage risks. In the event of a risk exposure exceeding established thresholds, management determines appropriate response actions. Responses, which may be taken by the Board of Directors, the Risk Oversight Committee, the Audit Committee, the Risk Committee, sub-committees or the CRO, or business units, may include (i) actions to directly mitigate or resolve risk, (ii) actions to terminate any activities resulting in an undesired or unintended risk position, or (iii) actions to prevent, avoid, modify, share or accept a risk position (or activity prior to its occurrence).

Risk Reporting

As the constituents primarily responsible for proactively managing the risks to which they are exposed, our business units and risk and control functions periodically report to the governance committees. The CRM function is responsible for independent reporting on risk matters to various constituencies across the Company on a periodic basis. The CRM department periodically provides risk management reporting to the Risk Committee, the Audit Committee, the Risk Oversight Committee and the Board of Directors.

Stress Testing

We use stress testing to better understand the range of potential risks and their impacts to which the Company is exposed. A stress testing framework is employed to provide a comprehensive, integrated and forward-looking assessment of material risks and vulnerabilities. Stress test results provide information for business strategy, risk appetite setting, and decisions related to capital actions, contingency capital plans, liquidity buffer, contingency funding plans and balance sheet positioning. Our stress testing framework utilizes a risk inventory, which covers our risk exposures across our defined risk categories. The risk inventory provides a comprehensive view of our vulnerabilities capturing current and emerging risks from management's view, granular risks relevant to business units and emerging risks associated with new initiatives.

Risk Management Review of Compensation

We believe in a pay for performance philosophy, which considers performance across the Company, business segments and individual performance, as appropriate, as well as the long-term interests of our shareholders and the safety and soundness of the Company. We design compensation to be competitive relative to our peers to attract, retain and motivate our employees. In addition to being competitive in the markets in which we compete for talent and encouraging employees to achieve objectives set out by our management, our compensation programs are designed to balance an appropriate mix of compensation components to align the interests of employees with the long-term interests of shareholders and the safety and soundness of the Company.

The design and administration of our compensation programs provide incentives that seek to appropriately balance risk and financial results in a manner that does not incentivize employees to take imprudent risks, is compatible with effective controls and enterprise-wide risk management, and is supported by strong corporate governance, including oversight by our Board of Directors and the Compensation and Leadership Development Committee of our Board of Directors.

Risk Appetite and Strategic Limit Structure

Risk appetite is defined as the aggregate level and the type of risks we are willing to accept or avoid in order to achieve our strategic objectives. Risk appetite expressions are consistent with the Company's aspirations, mission statement and core values, and also serve as tools to preclude business activities that could have a negative impact on our reputation.

Risk appetite is expressed through both quantitative limits and qualitative expressions to recognize a range of possible outcomes and to help set boundaries for proactive management of risks. Risk appetite measures take into account the risk profile of the businesses, the external macroeconomic environment and stakeholder views, including those of shareholders, regulators, ratings agencies and customers. These limits and expressions are revised at least annually or as warranted by changes in business strategy, risk profile and external environment.

Management and our CRM department monitor approved limits and escalation triggers to ensure that the business is operating within the approved risk appetite. Risk limits are monitored and reported on to various risk sub-committees, the Risk Committee and our Board of Directors, as appropriate. Through ongoing monitoring of risk exposures, management seeks to be able to identify appropriate risk response and mitigation strategies in order to react dynamically to changing conditions.

Capital Planning

Risk exposures identified through the risk identification process across risk categories and risk types are consolidated to create a comprehensive risk inventory. This inventory is leveraged by a number of processes within the Company including stress scenario design, capital planning, risk appetite setting and risk modeling. The risk inventory is reviewed and approved at least annually by the Capital Planning Committee along with the Risk Committee and sub-committees to ensure transparency and comprehensive coverage of risk exposures. Our capital planning and management framework encompasses forecasting capital levels, establishing capital targets, monitoring capital adequacy against targets, maintaining appropriate contingency capital plans and identifying strategic options to deploy excess capital.

Supervision and Regulation

General

Our operations are subject to extensive regulation, supervision and examination under U.S. federal, state and foreign laws and regulations. As a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act, we are subject to the supervision, examination and regulation of the Federal Reserve. As a large provider of consumer financial services, we are subject to the supervision, examination and regulation of the Consumer Financial Protection Bureau (the “CFPB”).

We operate two banking subsidiaries, each of which is in the United States. Discover Bank, our main banking subsidiary, offers credit card loans, student loans, personal loans and home equity loans as well as certificates of deposit, savings and checking accounts and other types of deposit accounts. Discover Bank is chartered and regulated by the Office of the Delaware State Bank Commissioner (the “Delaware Commissioner”), and is also regulated by the FDIC, which insures its deposits up to applicable limits and serves as the bank’s primary federal banking regulator. Our other bank, Bank of New Castle, is also chartered and regulated by the Delaware Commissioner and insured and regulated by the FDIC.

Bank Holding Company Regulation

Permissible activities for a bank holding company include owning a bank as well as 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 non-financial activities that are related to commerce such as manufacturing or retail sales of non-financial products.

A financial holding company and the non-bank companies under its control are permitted to engage in activities considered financial in nature, incidental to financial activities, or complementary to financial activities, if the Federal Reserve determines that such activities pose no risk to the safety or soundness of depository institutions or the financial system in general. Being a financial holding company under the Gramm-Leach-Bliley Act requires that the depository institutions that we control meet certain criteria, including capital, management and Community Reinvestment Act requirements. In addition, under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) we are required to meet certain capital and management criteria to maintain our status as a financial holding company. Failure to meet the criteria for financial holding company status results in restrictions on new financial activities or acquisitions and could require discontinuance of existing activities that are not generally permissible for bank holding companies.

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

The Dodd-Frank Act addresses risks to the economy and the payments system, especially those posed by large systemically significant financial firms. The Economic Growth, Regulatory Relief, and Consumer Protection Act (“EGRRCPA”) amended the Dodd-Frank Act by raising the asset size thresholds for certain enhanced prudential standards. Under the amended statute, the Federal Reserve is authorized to impose certain enhanced prudential standards on bank holding companies with total assets of at least \$100 billion, including Discover, only after issuing a new regulation or order based on a risk-based determination. In October 2019, the federal banking regulators approved final rules that tailor the existing regulatory requirements related to capital, liquidity and enhanced prudential standards to an institution’s risk and complexity profile for banking institutions with total consolidated assets of \$100 billion or more. Under the final rules, Discover is considered a Category IV institution and therefore subject to the least stringent category of enhanced prudential standards for bank holding companies with at least \$100 billion in total assets. Among other things, Discover is required to submit to supervisory stress tests every other year rather than annually, is no longer subject to regulations requiring Discover to submit the results of company-run capital stress tests, and is no longer subject to the liquidity coverage ratio. Discover is however still required to submit annual capital plans to the Federal Reserve and remains subject to other core components of the enhanced prudential standards rules, such as risk-management and risk committee requirements and liquidity risk management regulations. The final rules became effective December 31, 2019.

Discover is required to submit a capital plan to the Federal Reserve and participate in its 2020 Comprehensive Capital Analysis and Review (“CCAR”) stress tests. Despite not being subject to the CCAR process in 2019, Discover was still required to prepare and submit a capital plan that was approved by its Board of Directors, which contained planned capital distributions for the period from July 1, 2019 to June 30, 2020 based on a formula that was largely based on results from the Federal Reserve’s 2018 CCAR stress test.

Beginning in 2020, Discover is subject to the Federal Reserve’s new supervisory rating system for large financial institutions (“LFI Rating System”). The LFI Rating System is intended to align more closely with the Federal Reserve’s current supervisory programs for large financial institutions, enhance the clarity and consistency of supervisory assessments, and provide greater transparency regarding the consequences of a given rating. Under the LFI Rating System, the Federal Reserve will evaluate and assign ratings for the following three components: capital planning and positions; liquidity risk management and positions; and governance and controls. Unlike the prior supervisory rating system, the LFI Rating System does not include an overall composite rating. An institution subject to the LFI Rating System, such as Discover, would not be considered “well managed” under applicable regulations if it is assigned a deficient rating in any one component, which could be a barrier for seeking the Federal Reserve’s approval to engage in new or expansionary activities.

Regulatory and supervisory developments, findings and ratings could negatively impact our business strategies or require us to: limit or change our business practices, restructure our products in ways that we may not currently anticipate, limit our product offerings, invest more management time and resources in compliance efforts, limit the fees we can charge for services or limit our ability to pursue certain business opportunities and obtain related required regulatory approvals. For additional information regarding bank regulatory limitations on acquisitions and investments, see “— Acquisitions and Investments.” See Note 19: Litigation and Regulatory Matters to our consolidated financial statements for more information on recent matters affecting Discover. Regulatory developments could also influence our strategies, impact the value of our assets or otherwise adversely affect our businesses. For more information regarding the regulatory environment and developments under the Dodd-Frank Act, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments” and “Risk Factors.”

Capital, Dividends and Share Repurchases

We, Discover Bank and Bank of New Castle are subject to capital adequacy guidelines adopted by federal banking regulators, which include maintaining minimum capital and leverage ratios for capital adequacy and higher ratios to be deemed “well-capitalized” for other regulatory purposes. We and our subsidiary banks are each required to maintain Tier 1 and total capital equal to at least 6% and 8% of our total risk-weighted assets, respectively. We and our subsidiary banks are also required to maintain a minimum “leverage ratio” (Tier 1 capital to adjusted total assets) of 4% and a common equity Tier 1 capital ratio (common equity Tier 1 capital to total risk-weighted assets) of 4.5%. Further, under the Federal Reserve’s current capital plan requirements, Discover Financial Services is required to demonstrate that under stress scenarios we will maintain each of the minimum capital ratios on a pro-forma basis throughout the nine-quarter planning horizon.

In addition to the supervisory minimum levels of capital described above, Federal Reserve rules applicable to Discover Financial Services require maintenance of the following minimum capital ratios to be considered “well-capitalized” for certain purposes under Regulation Y (12 CFR 225): (i) a Tier 1 risk-based capital ratio of 6% and (ii) a total risk-based capital ratio of 10%. Our banking subsidiaries are required by the FDIC’s Prompt Corrective Action rules to maintain the following minimum capital ratios to be considered “well-capitalized”: (i) a common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 risk-based capital ratio of 8%; (iii) a total risk-based capital ratio of 10%; and (iv) a Tier 1 leverage ratio of 5%. At December 31, 2019, Discover Financial Services met all requirements to be deemed “well-capitalized” pursuant to the applicable regulations. For related information regarding our bank subsidiaries see “— FDIA” below.

There are various federal and state law limitations on the extent to which our banking subsidiaries can provide 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, affiliate transaction limits 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 our banking subsidiaries, 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. For more information, see “— FDIA” below.

Additionally, we are subject to regulatory requirements imposed by the Federal Reserve as part of its stress testing framework and its CCAR program. As discussed above, in 2019 Discover was notified that it was not required to participate in CCAR or submit to supervisory stress tests for the 2019 stress test cycle. However, Discover's capital distributions for the period between July 1, 2019 and June 30, 2020 are limited based on a formula that is largely based on results from the Federal Reserve's 2018 supervisory stress test. Discover is required to submit a capital plan to the Federal Reserve and participate in the 2020 CCAR stress tests. Therefore, Discover's capital distributions during the period between July 1, 2020 and June 30, 2021 will be subject to regulatory constraints that are based on the results of the 2020 supervisory stress tests.

For more information, including additional conditions and limits on our ability to pay dividends and repurchase our stock, see “— Bank Holding Company Regulation,” “Risk Factors — Credit, Market and Liquidity Risk — *We may be limited in our ability to pay dividends on and repurchase our stock*” and “— *We are a holding company and depend on payments from our subsidiaries*,” “Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Capital” and Note 17: Capital Adequacy to our consolidated financial statements.

FDIA

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 December 31, 2019, Discover Bank and Bank of New Castle met all applicable requirements to be deemed “well-capitalized.”

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 the capital restoration plan.

If a depository institution fails to submit an acceptable capital restoration 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 insured banks from accepting brokered deposits or offering interest rates on any deposits significantly higher than the prevailing rate in the bank's normal market area or nationally (depending upon where the deposits are solicited), unless it is “well-capitalized,” or it is “adequately capitalized” and receives a waiver from the FDIC. Under current FDIC regulations, a bank that is less than “well-capitalized” is generally prohibited from paying an interest rate on deposits in excess of 75 basis points over the national market average. There are no such restrictions under the FDIA on a bank that is “well-capitalized.” As of December 31, 2019, 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 — Credit, Market and Liquidity Risk — *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” 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.

The FDIA subjects Discover Bank to deposit insurance assessments. Under the Dodd-Frank Act, in order to bolster the reserves of the Deposit Insurance Fund, the minimum reserve ratio set by the FDIC was increased to 1.35% and subsequently the FDIC set a reserve ratio of 2%. The Dodd-Frank Act removed the statutory cap for the reserve ratio, leaving the FDIC free to set a cap in the future. The FDIC also previously amended its deposit insurance regulations in ways that have raised Discover Bank's cost of deposit insurance. Further increases may occur in the future.

Acquisitions and Investments

Since we are a bank holding company, and Discover Bank and Bank of New Castle are insured depository institutions, we are subject to banking laws and regulations that limit the types of acquisitions and investments that we can make. In addition, certain permitted acquisitions and investments that we seek to make are subject to the prior review and approval of our banking regulators, including the Federal Reserve and FDIC. Our banking regulators have broad discretion on whether to approve proposed acquisitions and investments. In deciding whether to approve a proposed acquisition, federal bank regulators will consider, among other factors, the effect of the acquisition on competition, our financial condition, and our future prospects, including current and projected capital ratios and levels; the competence, experience, and integrity of our management and our record of compliance with laws and regulations; the convenience and needs of the communities to be served, including our record of compliance under the Community Reinvestment Act; and our effectiveness in combating money laundering. Therefore, results of supervisory activities of the banking regulators, including examination results and ratings, can impact whether regulators approve proposed acquisitions and investments. For more information on recent matters affecting Discover, see Note 19: Litigation and Regulatory Matters to our consolidated financial statements. For information on the regulatory environment, see "Risk Factors."

In addition, certain acquisitions of our voting stock may be subject to regulatory approval or notice under U.S. federal or Delaware state law. Investors are responsible for ensuring that they do not, directly or indirectly, acquire shares of our stock in excess of the amount that can be acquired without regulatory approval under the Change in Bank Control Act, the Bank Holding Company Act 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 Financial Services

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, the Gramm-Leach-Bliley Act, the Credit Card Accountability Responsibility and Disclosure Act, the Servicemembers Civil Relief Act, the Military Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act and the Dodd-Frank Act. These and other federal laws, among other things, prohibit unfair, deceptive and abusive trade practices, require disclosures of the cost of credit and other terms of credit and deposit accounts, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide privacy protections, require safe and sound banking operations, restrict our ability to raise interest rates, protect customers serving in the military and their dependents and subject us to substantial regulatory oversight. The CFPB has rulemaking and interpretive authority under the Dodd-Frank Act and other federal consumer financial services laws, as well as broad supervisory, examination and enforcement authority over large providers of consumer financial products and services, such as Discover. For more information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments — Consumer Financial Services." State and, in some cases, local laws also may regulate in these areas, as well as in the areas of collection practices, and may provide other additional consumer protections.

Violations of applicable consumer protection laws can result in significant potential liability in litigation by customers, including civil monetary 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. Further violations may cause federal banking regulators to deny, or delay approval of, potential acquisitions and investments. See "— Acquisitions and Investments."

We are subject to additional laws and regulations affecting mortgage lenders. Federal, state and, in some instances, local laws apply to mortgage lending activities. These laws generally regulate the manner in which mortgage lending and lending-related activities are conducted, including advertising and other consumer disclosures, payments for services and recordkeeping requirements. These laws include the Real Estate Settlement Procedures Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act and various state laws. For more information, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments — Consumer Financial Services.”

Payment Networks

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 federal and state 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 regulators and the National Credit Union Administration. 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 unpermitted disclosure of confidential customer information could have a material adverse impact on our business, including loss of consumer confidence.

The Dodd-Frank Act contains several provisions that are relevant to the business practices, network transaction volume, revenue and prospects for future growth of PULSE, our debit card network business. The Dodd-Frank Act requires that merchants control the routing of debit transactions, and that interchange fees received by certain payment card issuers on debit card transactions be “reasonable and proportional” to the issuer’s cost in connection with such transactions, as determined by the Federal Reserve. The Dodd-Frank Act also requires the Federal Reserve to restrict debit card networks and issuers from requiring debit card transactions to be processed solely on a single payment network or two or more affiliated networks, or from requiring that transactions be routed over certain networks. For information regarding related impacts on our debit card business, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments — Payment Networks.”

Money Laundering & Terrorist Financing Prevention Program

We maintain an enterprise-wide program designed to comply with all applicable anti-money laundering and anti-terrorism laws and regulations, including the Bank Secrecy Act and the USA PATRIOT Act of 2001. This program includes policies, procedures, training and other internal controls designed to mitigate the risk of money laundering or terrorist financing posed by our products, services, customers and geographic locale. These controls include procedures and processes to detect and report suspicious transactions, perform customer due diligence, and meet all recordkeeping and reporting requirements related to particular transactions involving currency or monetary instruments. The program is coordinated by our anti-money laundering compliance and sanctions officer and undergoes regular independent audits to assess its effectiveness. Our program is typically reviewed on an annual basis by federal banking regulators. On February 13, 2020, the Federal Reserve Board announced that the May 2015 written agreement between Discover Financial Services and the Federal Reserve Bank of Chicago related to Discover Financial Services’ anti-money laundering and related compliance programs had been terminated effective February 5, 2020. See Note 19: Litigation and Regulatory Matters to our consolidated financial statements for more information. For additional information regarding bank regulatory limitations on acquisitions and investments, see “— Acquisitions and Investments.”

Sanctions Programs

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

Information About Our Executive Officers

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

Name	Age	Position
Roger C. Hochschild	55	Chief Executive Officer and President
John T. Greene	54	Executive Vice President, Chief Financial Officer
Brian D. Hughes	52	Executive Vice President, Chief Risk Officer
Daniel P. Capozzi	48	Executive Vice President, President - Credit Operations and Decision Management
R. Andrew Eichfeld	50	Executive Vice President, Chief Human Resources and Administrative Officer
Julie A. Loeger	56	Executive Vice President, President - U.S. Cards
Carlos M. Minetti	57	Executive Vice President, President - Consumer Banking
Diane E. Offereins	62	Executive Vice President, President - Payment Services
Glenn P. Schneider	58	Executive Vice President, Chief Information Officer
Wanjiku J. Walcott	49	Executive Vice President, Chief Legal Officer and General Counsel

Roger C. Hochschild is our Chief Executive Officer and President, a position he has held since October 2018. Mr. Hochschild was also elected to the Discover Board of Directors in August 2018. From 2004 to 2018, Mr. Hochschild served as President and Chief Operating Officer. Prior to that, he was Executive Vice President, Chief Administrative and Strategic Officer (2001 to 2004) and Executive Vice President, Chief Marketing Officer - Discover (1998 to 2001) of our former parent company 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.

John T. Greene is our Executive Vice President, Chief Financial Officer. He has held this role since September 2019. Prior to joining Discover, Mr. Greene served as Executive Vice President, Chief Financial Officer and Treasurer at Bioverativ, a global biopharmaceutical company. From 2014 to 2016, he was Chief Financial Officer for Willis Group Holdings, which was preceded by more than eight years at HSBC Holdings where he held CFO positions for several divisions, including retail bank and wealth management, insurance and consumer and mortgage lending. He also held various CFO roles in his 12-year tenure with General Electric from 1993 to 2005. Mr. Greene holds a Bachelor's degree in accounting from the State University of New York and an M.B.A. from the Kellogg School of Management at Northwestern University.

Brian D. Hughes is our Executive Vice President, Chief Risk Officer. He has held this role since December 2016 and been Chief Risk Officer since May 2016. Mr. Hughes joined Discover in 2012 as Senior Vice President and held leadership positions in Credit Risk Management, Deposit Products and Cardmember Marketing. Prior to joining us, Mr. Hughes held leadership roles at HSBC North America (2004-2012) and Booz & Co. (1993-2004). He holds a Bachelor's degree in Electrical Engineering from the University of Illinois and an M.B.A. from the Booth School of Business at The University of Chicago.

Daniel P. Capozzi is our Executive Vice President, President - Credit Operations and Decision Management. He has held this role since October 2018 and previously served as Senior Vice President, Credit and Decision Management beginning in June 2017. Since joining Discover in 2007, Mr. Capozzi has held leadership positions in the Deposits business and Corporate Finance. Prior to joining Discover, he held various leadership positions in Finance at Citi and Bank of America. Mr. Capozzi holds a Bachelor's degree in Business Administration from Northeastern University.

R. Andrew Eichfeld is our Executive Vice President, Chief Human Resources and Administrative Officer. He has held this role since September 2018. Prior to joining Discover, Mr. Eichfeld was an independent advisor from 2017 to 2018 and held various positions at McKinsey & Company from 1995 to 2017, where he was elected a senior partner in 2009. Mr. Eichfeld holds a Bachelor's degree in Government from Oberlin College, as well as a Master's degree in Middle Eastern studies and an M.B.A. in Marketing, both from the University of Chicago.

Julie A. Loeger is our Executive Vice President, President - U.S. Cards. She has held this role since October 2018. She served as Executive Vice President, Chief Marketing Officer from December 2015 to October 2018 and was Senior Vice President, Chief Marketing Officer from April to December 2015. Ms. Loeger joined Discover in 1991 and has held leadership positions in many areas, including Rewards, Portfolio Marketing, Acquisition, Brand Management and Product Development. Prior to joining Discover, she held various marketing positions at Anheuser Busch, Inc. She holds a Bachelor's of Business Administration degree in Finance from The University of Texas at San Antonio, an M.B.A. from Loyola University Chicago and attended the executive program at The Amos Tuck School at Dartmouth College.

Carlos M. Minetti is our Executive Vice President, President - Consumer Banking. He has held this role since February 2014. Previously, he served as Executive Vice President, President - Consumer Banking and Operations (2010 to 2014), Executive Vice President, Cardmember Services and Consumer Banking (2007 to 2010), and Executive Vice President for Cardmember Services and Chief Risk Officer (2001 to 2007). 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 degree in Industrial Engineering from Texas A & M University and an M.B.A. from the Booth School of Business at The University of Chicago.

Diane E. Offereins is our Executive Vice President, President - Payment Services. She has held this role since April 2010. Previously, she served as Executive Vice President, Payment Services (2008 to 2010) and Executive Vice President and Chief Technology Officer (1998 to 2008). In 2006, she assumed leadership of the PULSE network. Prior to joining us, Ms. Offereins worked at MBNA America Bank from 1993 to 1998, most recently as Senior Executive Vice President. Ms. Offereins holds a Bachelor's degree in Accounting from Loyola University New Orleans.

Glenn P. Schneider is our Executive Vice President, Chief Information Officer. He has held this role since January 2015. Previously, he served as Senior Vice President and Chief Information Officer (2008 to 2015), Senior Vice President, Application Development (2003 to 2008), and Vice President, Marketing Applications (1998 to 2003). Prior to joining us in 1993, Mr. Schneider worked for Kemper Financial Services as a Programmer. He holds a Bachelor's degree in Economics/Computer Science with a minor in Statistics from Northern Illinois University.

Wanjiku J. Walcott is our Executive Vice President, Chief Legal Officer and General Counsel. She has held this role since July 2019. Prior to joining Discover, Ms. Walcott served as Senior Vice President and General Counsel at PayPal, where she led the company's global legal organization. From 2002 to 2015, she held multiple leadership roles at American Express, where she last served as Senior Vice President, Managing Counsel. Ms. Walcott holds a Bachelor's degree in Philosophy from Howard University and a Juris Doctor from the Howard University School of Law.

Item 1A. Risk Factors

You should carefully consider each of the following risks described below and all of the other information in this annual report on Form 10-K in evaluating us. Our business, financial condition, cash flows and/or results of operations could be materially adversely affected by any of these risks. The trading price of our common stock could decline due to any of these risks. This annual report on Form 10-K also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this annual report on Form 10-K. See “Special Note Regarding Forward-Looking Statements,” which immediately follows the risks below.

Current Economic and Regulatory Environment

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

As a provider of consumer financial services, our business, results of operations and financial condition are subject to the United States and global economic environment. While the economy appears to be stable, we are experiencing the normalization of delinquency and charge-off rates and entering a period during which these rates increase to long-run levels as the supply of consumer credit grows. A customer's ability and willingness to repay us can be negatively impacted by not only economic conditions but also a customer's other payment obligations.

Economic conditions also can reduce the usage of credit cards in general and the average purchase amount of transactions industry-wide, including our cards, which reduces interest income and transaction fees. We rely heavily on interest income from our credit card business to generate earnings. Our interest income from credit card loans was \$9.7 billion for the year ended December 31, 2019, which was 85% of net revenues (defined as net interest income plus other income), compared to \$8.8 billion for the year ended December 31, 2018, which was 83% of net revenues. Economic conditions combined with a competitive marketplace could result in slow loan growth, resulting in reduced revenue growth from our core direct banking business.

Financial regulatory developments have and will continue to significantly impact the environment for the financial services industry, which could adversely impact our business, results of operations and financial condition.

The EGRRCPA was signed into law on May 24, 2018. The act generally redefined a U.S. domestic Systemically Important Financial Institution as a banking institution with assets above \$250 billion or that meets other risk-based criteria and required the federal banking agencies to tailor their enhanced prudential regulations for domestic bank holding companies accordingly. The banking agencies issued final rules to implement the tailoring requirements of the EGRRCPA in November 2019, with an effective date of December 31, 2019. Under the final rules, Discover is considered a Category IV institution and therefore subject to the least stringent category of enhanced prudential standards for domestic bank holding companies with at least \$100 billion in total assets. Accordingly, Discover will be subject to slightly more tailored requirements for capital stress testing, liquidity risk management and resolution planning beginning in 2020. However, many of the core components of these regulations remain in place.

Meanwhile, the portions of the Dodd-Frank Act unchanged by the EGRRCPA remain law, including provisions governing the practices and oversight of financial institutions and other firms that participate in financial markets. The Senate and regulatory agency leadership may continue to support tailoring of the regulatory burden on large financial institutions, including Discover. Further legislative changes to the Dodd-Frank Act remain uncertain due to the potentially divergent agendas of the House and Senate and upcoming elections. Further, the outcome of supervisory and regulatory reform efforts at the federal banking agencies remains uncertain. Also, it is possible that regulatory reform measures may disproportionately benefit our competitors or not benefit Discover at all due to our size, structure or product offerings, among other things.

The impact of the evolving regulatory environment on our business and operations depends upon a number of factors including the supervisory priorities and actions of the Federal Reserve, the FDIC and the CFPB, the actions of our competitors and other marketplace participants, as well as the behavior of consumers. Regulatory developments, findings and actions have, and could continue to, negatively impact our business strategies or require us to: limit, exit or change our business practices, restructure our products in ways that we may not currently anticipate, limit our product offerings, invest more management time and resources in compliance efforts, limit the fees we can charge for services, or limit our ability to pursue certain business opportunities and obtain related required regulatory approvals. For example, the Federal Reserve and the FDIC enforcement actions related to our anti-money laundering program have caused us to change our processes and incur significant expenses. For additional information regarding bank

regulatory limitations on acquisitions and investments, see “Business — Supervision and Regulation — Acquisitions and Investments.” See also Note 19: Litigation and Regulatory Matters to our consolidated financial statements for more information on recent matters affecting Discover. Regulatory developments could also influence our strategies, impact the value of our assets, or otherwise adversely affect our businesses.

Compliance expectations and expenditures have increased significantly for Discover and other financial services firms, and are expected to continue to increase as regulators remain focused on controls and operational processes and we introduce new products or features or enter into new business arrangements. We may face additional compliance and regulatory risk to the extent that we enter into new business arrangements with third-party service providers, alternative payment providers, or other industry participants. The additional expense, time and resources needed to comply with ongoing or additional regulatory requirements may adversely impact our business and results of operations.

For more information regarding the regulatory environment and developments potentially impacting Discover, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments.”

Strategic Business Risk

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

The consumer financial services business is highly competitive. We compete with other consumer financial services providers, including non-traditional providers such as financial technology firms, on the basis of a number of factors, including brand, reputation, customer service, product offerings, incentives, pricing, e-wallet participation and other terms. Competition in credit cards is also based on merchant acceptance and the value provided to the customer by rewards programs. Many credit card issuers have instituted rewards programs that are similar to ours, and, in some cases, could be viewed as more attractive to customers than our programs. These competitive factors affect our ability to attract and retain customers, increase usage of our products and maximize the revenue generated by our products. 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. The competitive marketplace could result in slower loan growth, resulting in reduced revenue growth from our core direct banking business. 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 cost in competing with other consumer financial services providers, and many of our competitors have greater financial resources than we do, which may place us at a competitive disadvantage and negatively affect our financial results.

We incur considerable cost in competing with other consumer financial services providers to attract and retain customers and increase usage of our products. A substantial portion of this cost relates to marketing expenditures and rewards programs. Since 2013 our rewards rate, which represents rewards cost divided by Discover Card sales volume, has increased from less than 1% to 1.33% in 2019. We expect the competitive intensity in the rewards space to continue, which could result in a continued increase in the rewards rate. Our consumer financial services products compete primarily on the basis of pricing, terms and service. Because of the highly competitive nature of the credit card-issuing business, a primary method of competition among credit card issuers, including us, has been to offer rewards programs, low introductory interest rates, attractive standard purchase rates and balance transfer programs that offer a favorable annual percentage rate or other financial incentives for a specified length of time on account balances transferred from another credit card.

Competition is intense in the credit card industry, and customers may frequently switch credit cards or transfer their balances to another card. We expect to continue to invest in initiatives to remain competitive in the consumer financial services industry, including the launch of new cards and features, brand awareness initiatives, targeted marketing, online and mobile enhancements, e-wallet participation, customer service improvements, credit risk management and operations enhancements, and infrastructure efficiencies. There can be no assurance that any of the cost we incur or incentives we offer to attempt to acquire and maintain accounts and increase usage of our products

will be effective. In addition, to the extent that we offer new products, features or services to remain competitive, we may be subject to increased operational or other risks.

Furthermore, many of our competitors are larger than we are, have greater financial resources than we do, have more breadth in banking products, have lower funding costs than we have and expect to have, and have assets, such as branch locations and co-brand relationships, that may be appealing to certain customers. For example, larger credit card issuers, which have greater resources than we do, may be better positioned to fund appealing rewards, marketing and advertising programs. We may be at a competitive disadvantage as a result of the greater financial resources, diversification and scale of many of our competitors.

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

We face competition from other operators of payment networks and alternative payment providers, 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 from our payment services business.

We face substantial and increasingly intense competition in the payments industry, both from traditional players and new, emerging alternative payment providers. For example, we compete with other payment networks to attract network partners to issue credit and debit cards and other card products on the Discover, PULSE and Diners Club networks, collectively the Discover Global Network. Competition with other operators of payment networks is generally based on issuer fees, fees paid to networks (including switch fees), merchant acceptance, network functionality, technological capabilities and other economic terms. Competition is also based on customer perception of service quality, brand image, reputation and market share. Further, we are facing increased competition from alternative payment providers, who may create innovative network or other arrangements with our primary competitors or other industry participants, which could adversely impact our costs, transaction volume and ability to grow our business.

Many of our competitors are well established, larger than we are and/or have greater financial resources or scale 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 enjoy greater merchant acceptance and broader global brand recognition than we do. Although we have made progress in merchant acceptance, we have not achieved global market parity with Visa and MasterCard. 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 cards on the Discover Network or issuing debit cards on the PULSE network. Some of these arrangements are exclusive, or nearly exclusive, which further limits our ability to conduct material amounts of business with these institutions. If we are unable to remain competitive on issuer fees and other incentives, we may be unable to offer adequate pricing to network partners while maintaining sufficient net revenues.

We also face competition as merchants put pressure on transaction fees. Increasing merchant fees or acquirer fees 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 network partners and our ability to maintain or grow revenues from our proprietary network. In addition, competitors' settlements with merchants and related actions, including pricing pressures and/or surcharging, could negatively impact our business practices. Competitor actions related to the structure of merchant and acquirer fees and merchant and acquirer transaction routing strategies have adversely affected and are expected to continue to adversely affect our PULSE network's business practices, network transaction volume, revenue and prospects for future growth, and entry into new product markets. Visa has entered into arrangements with some merchants and acquirers that have, and are expected to continue to have, the effect of discouraging those merchants and acquirers from routing debit transactions to PULSE. In addition, the Dodd-Frank Act's network participation requirements and competitor actions negatively impact PULSE's ability to enter into exclusivity arrangements, which affects PULSE's business practices and may materially adversely affect its network transaction volume and revenue. PULSE has a pending lawsuit against Visa with

respect to these competitive concerns. PULSE's transaction processing revenue was \$197 million and \$178 million for the years ended December 31, 2019 and 2018, respectively.

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

In addition, if we are unable to maintain sufficient network functionality to be competitive with other networks, or if our competitors develop better data security solutions or more innovative products and services than we do, our ability to retain and attract network partners and maintain or increase the revenues generated by our proprietary card-issuing business or our PULSE business may be materially adversely affected. Additionally, competitors may develop data security solutions, which as a consequence of the competitors' market power, we may be forced to use. In which case, our business may be adversely affected as they may be better positioned to absorb the costs over higher volumes or a larger customer base.

Our business depends upon relationships with issuers, merchant acquirers, other payment enablers and licensees, many of whom are financial institutions. The economic and regulatory environment and increased consolidation in the financial services industry decrease our opportunities for new business and may result in the termination of existing business relationships if a business partner is acquired or goes out of business. In addition, as a result of this environment, financial institutions may have decreased interest in engaging in new card issuance opportunities or expanding existing card issuance relationships, which would inhibit our ability to grow our payment services business. We continue to face substantial and intense competition in the payments industry, which impacts our revenue margins, transaction volume and business strategies.

If we are unsuccessful in maintaining our international network business and achieving meaningful global card acceptance, we may be unable to grow our international network business.

We continue to make progress toward, but have not completed, achieving global card acceptance for the Discover Global Network since we acquired the Diners Club network and related assets in 2008. Achieving global card acceptance would allow Discover customers, including third-party issuers leveraging the network, to use their cards at merchant and ATM locations around the world.

Our international network business depends upon the cooperation, support and continuous operation of the network licensees that issue Diners Club cards and that maintain a merchant acceptance network. As is the case for other card payment networks, our Diners Club network does not issue cards or determine the terms and conditions of cards issued by the network licensees. 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 due to the potential deterioration in customer relationships and related demand that could result. If one or more licensees were to experience a significant impairment of their business or were to cease doing business for economic, regulatory or other reasons, we would face the adverse effects of business interruption in a particular market, including loss of volume, acceptance and revenue, and exposure to potential reputational risk. If such conditions arise in the future, we may deploy resources and incur expenses in order to sustain network acceptance. Additionally, interruption of network licensee relationships could have an adverse effect on the acceptance of Discover cards when they are used on the Diners Club network outside of North America.

Also, as we have non-amortizable intangible assets that resulted from the purchase of Diners Club, if we are unable to maintain or increase revenues due to the reasons described above, we may be exposed to an impairment loss on the Diners Club acquisition that, when recognized, could have a material adverse impact on our results of operations. The long-term success of our international network business depends upon achieving meaningful global card acceptance, which has included and may continue to include higher overall costs or longer timeframes than anticipated.

The success of our student loan strategy depends upon our ability to manage the risks of our student loan portfolio and the student lending environment. If we fail to do so, we may be unable to sustain and grow our student loan portfolio.

The long-term success of our student loan strategy depends upon our ability to manage the credit risk, pricing, funding, operations, including the transition away from London Interbank Offered Rate ("LIBOR"), and expenses of our student loan portfolio, as well as grow student loan originations. Our student loan strategy is also impacted by external

factors such as the overall economic environment, a competitive marketplace and a challenging regulatory environment for private student loans and student loans generally. For more information on the regulatory environment, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments — Consumer Financial Services” and Note 19: Litigation and Regulatory Matters to our consolidated financial statements. Economic weakness, changes from legislation, government and regulatory focus on higher education costs, student lending and student loan servicing, as well as competitive factors, such as competition from non-traditional lenders such as financial technology firms, may present challenges to managing and growing our private student loan business in the future, and could cause us to restructure our private student loan products in ways that we may not currently anticipate. In addition, changes that adversely affect the private student loan market generally may negatively impact the profitability and growth of our student loan portfolio.

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

We may consider or undertake strategic acquisitions of, or material investments in, businesses, products, portfolios of loans or technologies in the future. We may not be able to identify suitable acquisition or investment candidates, or even if we do identify suitable candidates, they may be difficult to finance, expensive to fund and there is no guarantee that we can obtain any necessary regulatory approvals or complete the transactions on terms that are favorable to us. We generally must receive federal regulatory approvals before we can acquire a bank, bank holding company, deposits or certain assets or businesses. For additional information regarding bank regulatory limitations on acquisitions and investments, see “Business — Supervision and Regulation — Acquisitions and Investments.”

To the extent we pay the purchase price of any strategic acquisition or investment in cash, it may have an adverse effect on our financial condition; similarly, if the purchase price is paid with our stock, it may be dilutive to our stockholders. In addition, we may assume liabilities associated with a business acquisition or investment, including unrecorded liabilities that are not discovered at the time of the transaction, and the repayment or settlement of those liabilities may have an adverse effect on our financial condition.

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

Credit, Market and Liquidity Risk

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

We seek to grow our loan receivables while maintaining quality credit performance. 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 externally developed and 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 we may 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. At December 31, 2019 and 2018, \$1.3 billion, or 1.32%, and \$1.2 billion,

or 1.27%, of our loan receivables were non-performing (defined as loans over 90 days delinquent and accruing interest plus loans not accruing interest). While the U.S. economy appears to be stable, we are experiencing the normalization of delinquency and charge-off rates and entering a period during which these rates increase to long-run levels as the supply of consumer credit grows. Although we offer loan modification programs, there can be no assurance that our underwriting and portfolio management strategies will permit us to avoid high charge-off levels, or that our allowance for loan losses will be sufficient to cover actual losses.

A customer's ability and willingness to repay us can be negatively impacted by increases in their payment obligations to other lenders and by restricted availability of credit to consumers generally. Our collection operations may not compete effectively to secure more of customers' diminished cash flow than our competitors. In addition, we may fail to quickly identify customers who are likely to default on their payment obligations 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 restrictions on collections, bankruptcy laws, minimum payment regulations and re-age guidance), competitors' actions and consumer behavior, as well as inadequate collections staffing, resources, techniques and models.

We continue to expand our marketing of our non-credit card consumer lending products. A customer's ability and willingness to repay personal loans, private student loans and home equity loans may be more significantly impacted than other consumer loans by other debts or increases in their payment obligations to other lenders. Additionally, a customer's ability to repay personal loans, private student loans and home equity loans may be significantly impaired by the unavailability of consumer credit generally. There can be no assurance that we will be able to grow these products in accordance with our strategies, manage our credit and other risks associated with these products, or generate sufficient revenue to cover our expenses in these markets. Our failure to manage our credit and other 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 loan receivables, deposits, and proceeds from securitization transactions and securities offerings. We may maintain too much liquidity, which can be costly and limit financial flexibility, or we may be too illiquid, which could result in financial distress during a liquidity stress event. Our liquidity portfolio had a balance of approximately \$16.6 billion as of December 31, 2019, compared to \$15.9 billion as of December 31, 2018. Our total contingent liquidity sources amounted to \$56.3 billion as of December 31, 2019, compared to \$52.9 billion as of December 31, 2018. As of December 31, 2019, our total contingent liquidity sources consisted of \$16.6 billion in our liquidity portfolio, \$34.2 billion in incremental Federal Reserve discount window capacity, and \$5.5 billion of undrawn capacity in private securitizations.

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, new regulatory restrictions and requirements, and our credit ratings. Disruptions, uncertainty or volatility in the capital, credit or deposit markets, such as the volatility experienced in the capital and credit markets during the financial crisis of 2007, may limit our ability to repay or replace maturing liabilities in a timely manner. As such, we may be forced to delay the acquisition of additional funding or be forced to issue or raise funding at undesirable terms and/or costs, 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.

There can be no assurance that significant disruption and volatility in the financial markets will not occur in the future. Likewise, adverse developments with respect to financial institutions and other third parties with whom we maintain important financial relationships could negatively impact our funding and liquidity. If we are unable to continue to fund our assets through deposits or access capital markets on favorable terms, or if we experience an increase in our borrowing costs or otherwise fail to manage our liquidity effectively, our liquidity, operating results, financial results and condition may be materially adversely affected.

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 and through third-party securities brokerage firms that offer our deposits to their customers. We had \$54.4 billion in deposits acquired directly or through affinity relationships and \$18.3 billion in deposits originated through securities brokerage firms as of December 31, 2019, compared to \$44.7 billion and \$23.1 billion, respectively, as of December 31, 2018. Competition from other financial services firms that use deposit funding, the rates and services we offer on our deposit products, and our ability to maintain a high-quality customer experience may affect deposit renewal rates, costs or availability. Changes we make to the rates offered on our deposit products may affect our profitability (through funding costs) and our liquidity (through volumes raised). In addition, our ability to maintain existing or obtain additional deposits may be impacted by factors, including factors beyond our control, such as: perceptions about our reputation, brand, financial strength or quality of deposit servicing or branchless banking generally, which could reduce the number of consumers choosing to place deposits with us; third parties continuing or entering into affinity relationships or marketing arrangements with us; disruptions in technology services or the internet, generally; or third-party securities brokerage firms continuing to offer 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 in certain circumstances prohibits insured banks, such as our subsidiary Discover Bank, from accepting brokered deposits (as defined in the FDIA) and applies other restrictions, such as a cap on interest rates we may pay. See “Business — Supervision and Regulation” and Note 17: Capital Adequacy to our consolidated financial statements for more information. While Discover Bank met the FDIC’s definition of “well-capitalized” as of December 31, 2019, and has no restrictions regarding acceptance of brokered deposits or setting of interest rates, there can be no assurance that it will continue to meet this definition. 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.

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

We use 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 as well as for contingent liquidity. Our average level of credit card securitized borrowings from third parties was \$14.4 billion and \$16.0 billion for the years ended December 31, 2019 and 2018, respectively. There can be no assurance that there will not be future disruptions in the credit card securitization market similar to those experienced during the financial crisis. Our ability to raise funding through the securitization market also depends, in part, on the credit ratings of the securities we issue from our securitization trusts. If we are not able to satisfy rating agency requirements to confirm the ratings of asset-backed securities issued by our trusts at the time of a new issuance of securities, it could limit our ability to access the securitization markets. Additional factors affecting the extent to which we may securitize our credit card receivables in the future include the overall credit quality of our receivables, the costs of securitizing our receivables, the demand for credit card asset-backed securities, and the legal, regulatory, accounting or tax rules affecting securitization transactions and asset-backed securities, generally. A prolonged inability to securitize our credit card receivables, or an increase in the costs of such issuances, may have a material adverse effect on our liquidity, cost of funds and overall financial condition.

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

Our liquidity would be materially adversely affected by the occurrence of events that could result in the early amortization of our existing credit card securitization transactions. Our credit card securitizations are structured as “revolving transactions” that do not distribute to securitization investors their share of monthly principal payments received on the underlying receivables during the revolving period, and instead use those principal payments to fund the purchase of new receivables. The occurrence of an “early amortization event” may result in termination of the revolving periods of our securitization transactions, which would require us to repay the affected outstanding securitized borrowings out of principal collections without regard to the original payment schedule. Early amortization events include, for example, insufficient cash flows in the securitized pool of receivables to meet contractual requirements (i.e. excess spread less than zero) and certain breaches of representations, warranties or covenants in the agreements relating to the securitization. For more information on excess spread, see Note 5: Credit Card and Student

Loan Securitization Activities to our consolidated financial statements. 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. An early amortization event also could impact our ability to access the undrawn conduit facilities that we maintain for contingent liquidity purposes.

Our credit card securitization structure includes a requirement that we accumulate principal collections into a restricted account in the amount of scheduled maturities on a pro rata basis over the 12 months prior to a security's maturity date. We have the option under our credit card securitization documents to shorten this accumulation period, subject to the satisfaction of certain conditions. 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, 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 that may change from time to time, including our financial strength as well as factors that may not be within our control. Factors that affect our unsecured credit ratings include, but are not limited to, the macroeconomic environment in which we operate and the credit ratings of the U.S. government, the credit quality and performance of our assets, the amount and quality of our capital, the level and stability of our earnings, and the structure and amount of our liquidity. In addition to these factors, the ratings of our asset-backed securities are also based on the quality of the underlying receivables and the credit enhancement structure of the trusts. Downgrades in our ratings or those of Discover Bank or our trusts could materially adversely affect our cost of funds, access to capital and funding, and overall financial condition. There can be no assurance that we will be able to maintain our current credit ratings or that our credit ratings will not be lowered or withdrawn.

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

We must effectively manage the risks of the investments in our liquidity investment portfolio, which is comprised of cash and cash equivalents and high-quality liquid investments. The value of our investments may be adversely affected by market fluctuations including changes in interest rates, prices, prepayment rates, credit risk premiums and overall market liquidity. Also, investments backed by collateral could be adversely impacted by changes in the value of the underlying collateral. In addition, economic conditions may cause certain of the obligors, counterparties and underlying collateral on our investments to incur losses of their own or default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons, thereby increasing our credit risk exposure to these investments. These risks could result in a decrease in the value of our investments, which could negatively impact our financial condition. These risks could also restrict our access to funding. While the securities in our investment portfolio are currently limited to obligations of high-quality sovereign and government-sponsored issuers, we may choose to expand the range of our investments over time, which may result in greater fluctuations in market value. While we expect these investments to be readily convertible into cash and do not believe they present a material increase to our risk profile or will have a material impact on our risk-based capital ratios, they are subject to certain market fluctuations that may reduce the ability to fully convert them into cash.

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

Changes in interest rates cause our net interest income to increase or decrease, as some of our assets and liabilities carry interest rates that fluctuate with market benchmarks. External factors may cause interest rates to increase. Tighter Federal Reserve monetary policy and rising interest rates would increase the cost of borrowing for consumers, businesses and governments. Higher interest rates could negatively impact Discover's customers as total debt service payments would increase, impede Discover's ability to grow its consumer lending businesses, and increase the cost of our funding, which would put Discover at a disadvantage as compared to competitors that have less expensive funding sources.

Some of our consumer loan receivables bear interest at a fixed rate or do not earn interest, and we are not able to increase the rate on those loans to offset any higher cost of funds, which could materially reduce earnings. At the same time, our variable-rate loan receivables, most of which are based on the prime rate, may not change at the same rate as our floating-rate borrowings or may be subject to a cap, subjecting us to basis risk.

On July 27, 2017, the UK Financial Conduct Authority announced that it would no longer encourage or compel banks to continue to contribute quotes and maintain LIBOR after 2021. Potential replacements for LIBOR are emerging; however, the transition process is ongoing and there can be no assurance that the transition will be without significant challenges, operational or otherwise. We have and continue to offer floating-rate student loans that are based on LIBOR. These loans comprise approximately 40% of our student loan portfolio, or approximately 4% of our overall loan portfolio.

Our floating-rate borrowings are limited to asset-backed securities issued by our securitization trusts. Uncertainty persists with respect to floating-rate debt instruments based on LIBOR that do not contain provisions that contemplate the cessation of LIBOR. While potential replacements for LIBOR are emerging, uncertainty about the comparability of such replacements to LIBOR persist and other factors may complicate an orderly transition away from LIBOR.

If the one-month LIBOR rate, or its replacement, were to increase without a corresponding increase in the prime rate, our earnings would be negatively impacted. While the majority of our existing certificates of deposit bear interest at fixed rates that do not fluctuate with market benchmarks, we may use derivative instruments to hedge the fixed rates associated with some of these certificates of deposit. However, the costs of new deposits fluctuate with interest rates. Moreover, although certificates of deposit we issue directly to consumers are subject to early withdrawal penalties, these penalties may not fully mitigate early withdrawal behavior in a rising interest rate environment.

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, most of 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 continually monitor interest rates and have a number of tools, including the composition of our investments, liability terms and interest rate derivatives, to manage our interest rate risk exposure. Changes in market assumptions regarding future interest rates could significantly impact our interest rate risk strategy, our financial position and results of operations. If our interest rate risk management strategies are not appropriately monitored or executed, these activities may not effectively mitigate our interest rate sensitivity or have the desired impact on our results of operations or financial condition. For information related to interest rate risk sensitivities, see "Quantitative and Qualitative Disclosures About Market Risk."

We may be limited in our ability to pay dividends on and repurchase our stock.

In the year ended December 31, 2019, we increased our quarterly common stock dividend to \$0.44 per share and repurchased approximately 7% of our outstanding common stock under our share repurchase program. The declaration and payment of future dividends, as well as the amount thereof, are subject to the discretion of our Board of Directors. The amount and size of any future dividends and share repurchases will depend upon regulatory limitations imposed by the Federal Reserve, and our results of operations, financial condition, capital levels, cash requirements, future prospects, regulatory review and other factors as further described in "Business — Supervision and Regulation — Capital, Dividends and Share Repurchases." Holders of our shares of common stock are subject to the prior dividend rights of holders of our preferred stock or the depository shares representing such preferred stock outstanding, and if full dividends have not been declared and paid on all outstanding shares of our preferred stock in any dividend period, no dividend may be declared or paid on or set aside for payment on our common stock. Banking laws and regulations and our banking regulators may limit or prohibit our payment of dividends on or our repurchase of our stock at any time. There can be no assurance that we will declare and pay any dividends on or repurchase our stock in the future.

We are a holding company and depend on payments from our subsidiaries.

Discover Financial Services, our parent holding company, depends on dividends, distributions and other payments from its subsidiaries, particularly Discover Bank, to fund dividend payments, share repurchases, payments on its obligations, including debt obligations, and to provide funding and capital as needed to its operating subsidiaries. Banking laws and regulations and our banking regulators may limit or prohibit our transfer of funds freely, either to or from our subsidiaries, at any time. These laws, regulations and rules may hinder our ability to access funds that we may

need to make payments on our obligations or otherwise achieve strategic objectives. For more information, see “Business — Supervision and Regulation — Capital, Dividends and Share Repurchases.”

Operational and Other Risk

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

Our risk management framework seeks to identify and mitigate risk and appropriately balance risk and return. We have established processes and procedures intended to identify, measure, manage, monitor and report the types of risk to which we are subject, including credit risk, market risk, liquidity risk, operational risk, compliance and legal risk, and strategic risk. We seek to monitor and control our risk exposure through a framework of policies, procedures, limits and reporting requirements.

Management of our risks in some cases depends upon the use of analytical and/or forecasting models. We use a variety of models to manage and inform decision-making with respect to customers, and for the measurement of risk including credit, market and operational risks and for our finance and treasury functions. Models used by Discover can vary in their complexity and are designed to identify, measure and mitigate risks at various levels such as loan-level, portfolio segments, entire portfolios and products. These models use a set of computational rules to generate numerical estimates of uncertain values to be used for assessment of price, financial forecasts, and estimates of credit, interest rate, market and operational risk. All models carry some level of uncertainty that introduces risks in the estimates.

If the models that we use to mitigate risks are inadequate, we may incur increased losses. In addition, there may be risks that exist, or that develop in the future, that we have not appropriately anticipated, identified or mitigated. If our risk management framework and models do not effectively identify or mitigate our risks, we could suffer unexpected losses and our financial condition and results of operations could be materially adversely affected.

If our security systems, or those of third parties, containing information about us, our customers or third parties with which we do business, are compromised, our business could be disrupted and we may be subject to significant financial exposure, liability and damage to our reputation.

Our direct banking and network operations rely heavily on the secure processing, storage and transmission of confidential or sensitive information about us, our customers and third parties with which we do business. Information security risks for financial institutions have increased and continue to increase in part because of the proliferation of new technologies, the use of the internet and cloud, mobile and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, activists, hackers, terrorist organizations, nation state actors and other external parties. Those parties may also attempt to fraudulently induce employees, customers or other users of our systems (including third parties) to disclose confidential or sensitive information in order to gain access to our data or that of our customers.

Our technologies, systems, networks and software, those of other financial institutions and other firms (such as hardware vendors, cloud providers and others), have been, and are likely to continue to be, the target of increasingly frequent cyber-attacks, malicious code, ransomware, denial of service attacks, phishing and other social engineering, other remote access attacks, and physical attacks that could result in unauthorized access, misuse, loss, unavailability or destruction of data (including confidential customer information), account takeovers, identity theft and fraud, unavailability of service or other events. These types of threats may derive from human error, fraud or malice on the part of external or internal parties, or may result from technological failure or otherwise.

Despite our efforts to ensure the integrity of our systems through our information security and business continuity programs, we may not be able to anticipate or to implement effective preventive measures against all known and unknown security threats, attacks or breaches or events of these types, especially because the techniques used change frequently and are becoming increasingly more sophisticated or are not recognized until launched or vulnerabilities in software or hardware are unknown or are unable to be entirely addressed even after becoming known, and because:

- Security attacks can originate from a wide variety of sources and geographic locations and may be undetected for a period of time.
- We rely on many third-party service providers and network participants, including merchants, and, as such, a security breach or cyber-attack affecting one of these third parties could impact us. For example, the financial services industry continues to see attacks against the environments where personal and identifiable information is handled. For additional information see the risk factor “— *We rely on third parties to deliver*

services. If we face difficulties managing our relationships with third-party service providers, our revenue or results of operations could be materially adversely affected.”

- To access our products and services, our customers may use computers and mobile devices that are beyond our security control systems.

We are subject to increasing risk related to information and data security as we increase acceptance of the Discover card internationally, expand our suite of online direct banking products, enhance our mobile payment technologies, acquire new or outsource some of our business operations, expand our internal usage of web-based products and applications, and otherwise attempt to keep pace with rapid technological changes in the financial services industry. Our efforts to mitigate this risk increase our expenses. While we continue to invest in our information security defenses (including cybersecurity defenses), if our security systems or those of third parties are penetrated or circumvented such that the confidentiality, integrity or availability of information about us, our customers, transactions processed on our networks or on third-party networks on our behalf or third parties with which we do business is compromised, we could be subject to significant liability that may not be covered by insurance, including significant legal and financial exposure, actions by our regulators, damage to our reputation, or a loss of confidence in the security of our systems, products and services that could materially adversely affect our business.

Cyber-attacks that are successful, or are perceived to be successful, in compromising the data or disrupting the services of other peer financial institutions, whether or not we are impacted, could lead to a general loss of customer confidence, which could negatively impact market perception of our products and services. Media reports of attempted cyber-attacks, service disruptions or vulnerabilities in our cybersecurity or other third-parties, could cause significant legal and financial exposure, lead to regulatory and legislative intervention, and cause an overall negative effect in our business. For additional information on risks in this area, see the risk factors below regarding fraudulent activity, the introduction of new products and services, the use of third parties for outsourcing, technology generally, and laws and regulations addressing consumer privacy and data use and security.

If we cannot remain organizationally effective, we will be unable to address the opportunities and challenges presented by our strategy and the increasingly dynamic and competitive economic and regulatory environment.

To remain organizationally effective, we must effectively empower, integrate and deploy our management and operational resources and incorporate global and local business, regulatory and consumer perspectives into our decisions and processes. In order to execute on our objective to be the leading consumer bank and payments partner, we must develop and implement innovative and efficient technology solutions and marketing initiatives while effectively managing legal, regulatory, compliance, security, operational and other risks as well as expenses. Examples include the implementation of a broader rollout of our checking product and a structure for a more competitive global network business. If we fail to develop and implement these solutions, we may be unable to expand quickly and the results of our expansion may be unsatisfactory. In addition, if we are unable to make decisions quickly, assess our opportunities and risks, execute our strategy, and implement new governance, managerial and organizational processes as needed in this increasingly dynamic and competitive economic and regulatory environment, our financial condition, results of operations, relationships with our business partners, banking regulators, customers and shareholders, and ultimately our prospects for achieving our long-term strategies, may be negatively impacted.

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

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

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

Discover card transaction dollar volume was concentrated among our top 100 merchants in 2019, with our largest merchant accounting for approximately 5% of that transaction volume. Transaction volume on the PULSE network was also concentrated among the top 100 merchants in 2019, with our largest merchant accounting for approximately 20% of PULSE transaction volume. These merchants could seek to negotiate better pricing or other financial incentives by conditioning their continued participation in the Discover Network and/or PULSE network on a change in 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. In addition, some of our merchants, primarily our remaining small- and mid-size merchants, are not contractually committed to us for any period of time and may cease to participate in the Discover Network at any time on short notice.

Actual or perceived limitations on acceptance of credit cards issued on the Discover Network or debit cards issued on the PULSE network could adversely affect the use of Discover cards by existing customers and the attractiveness of the Discover card to prospective customers. Also, we may have difficulty attracting and retaining network partners if we are unable to add or 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 our merchants or the rates they pay could materially adversely affect our business, financial condition, results of operations and cash flows.

Our business, financial condition and results of operations may be adversely affected by merchants' increasing focus 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 of 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 issuer fees, violate federal antitrust laws. There can be no assurance that they will not in the future bring legal proceedings against other credit card and debit card issuers and networks, including us. Merchants also may promote forms of payment with lower fees, such as ACH-based payments, or seek to impose surcharges at the point of sale for use of credit or debit cards. Merchant groups have also promoted federal and state legislation that would restrict issuer practices or enhance the ability of merchants, individually or collectively, to negotiate more favorable fees. The heightened focus by merchants on the fees charged by credit card and debit card networks, together with the Dodd-Frank Act and recent industry litigation, which would allow merchants to encourage customers to use other payment methods or cards and may increase merchant surcharging, could lead to reduced transactions on, or merchant acceptance of, Discover Network or PULSE network cards or reduced fees, any of which could adversely affect our business, financial condition and results of operations.

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

Natural disasters or other catastrophic events, including terrorist attacks, may have a negative effect on our business and infrastructure, including our information technology systems. Our Diners Club network, concentrated primarily on 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, political instability 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 and card activity and our resulting revenue. Overall network and card 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.

Fraudulent activity associated with our products or our networks could cause our brands to suffer reputational damage, the use of our products to decrease and our fraud losses to be materially adversely affected.

We are subject to the risk of fraudulent activity associated with merchants, customers and other third parties handling customer information. The risk of fraud continues to increase for the financial services industry in general. We

incurred fraud losses and other charges of \$96 million and \$83 million for the years ended December 31, 2019 and 2018, respectively. Credit and debit card fraud, identity theft and related crimes are prevalent and perpetrators are growing ever more sophisticated. Our resources, customer authentication methods and fraud prevention tools may be insufficient to accurately predict or prevent fraud. Additionally, our risk of fraud continues to increase as third parties that handle confidential consumer information suffer security breaches, acceptance of the Discover card grows internationally and we expand our direct banking business and introduce new products and features. 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. High-profile fraudulent activity could negatively impact our brand and reputation. 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 deposit accounts, 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.

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 these changes.

Technological changes continue to significantly impact the financial services and payment services industries. For example, we may be unsuccessful in deploying new technologies to strengthen our credit underwriting capabilities, enhance the effectiveness of our marketing efforts, ensure acceptance with new payment technologies, enhance customer service, drive efficiencies in back-office functions or reduce fraud. The increasingly competitive mobile, e-wallet and tokenization spaces are expected to continue to bring risks and opportunities to both our direct banking and payment services businesses.

The effect of technological changes on our business is both rapid and 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 products and services. Rapidly evolving technologies and new entrants in mobile and emerging payments pose a risk to Discover both as a card issuer and to the payments business. 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 consumers, merchants or 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 while also managing our expenses, it may impact our ability to compete effectively and materially adversely affect our business and earnings.

We rely on third parties to deliver services. If we face difficulties managing our relationships with third-party service providers, our revenue or results of operations could be materially adversely affected.

We depend on third-party service providers for many aspects of the operation of our business. For example, we depend on third parties for software and systems development, the timely transmission of information across our data transportation network, and for other telecommunications, processing, remittance, technology-related and other services in connection with our direct banking and payment services businesses. If a service provider fails to provide the services that we require or expect, or fails to meet contractual requirements, such as service levels, security requirements or compliance with applicable laws, the failure could negatively impact our business by adversely affecting our ability to process customers' transactions in a timely and accurate manner, otherwise hampering our ability to serve our customers, or subjecting us to litigation and regulatory risk for poor vendor oversight. Such a failure could adversely affect the perception of the reliability of our networks and services, and the quality of our brands, and could have a materially adverse effect on our reputation, revenues and/or our results of operations.

We rely on technology to deliver services. If key technology platforms become obsolete, or if we experience disruptions, including difficulties in our ability to process transactions, our revenue or results of operations could be materially adversely affected.

Our ability to deliver services to our customers and run our business in compliance with applicable laws and regulations may be affected by the functionality of our technology systems. The implementation of technology changes as well as patches and upgrades to maintain current and integrated systems may result in compliance issues and may, at least temporarily, cause disruptions to our business, including, but not limited to, systems interruptions, transaction processing errors and system conversion delays, all of which could have a negative impact on us. In addition, our transaction processing systems and other operational systems may encounter service interruptions at any time due to system or software failure, natural disaster or other reasons. Such services could be disrupted at any of our primary or back-up facilities or our other owned or leased facilities. Third parties to whom we outsource the maintenance and development of certain technological functionality may experience errors or disruptions that could adversely impact us and over which we may have limited control. In addition, there is no assurance that we will be able to sustain our investment in new technology to avoid obsolescence of critical systems and applications. A failure to maintain current technology, systems and facilities or to control third-party risk, could cause disruptions in the operation of our business, which could materially adversely affect our transaction volumes, revenues, reputation and/or our results of operations.

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

Our success depends, in large part, on our ability to recruit, retain and motivate key officers and employees to manage and grow our business. Our senior management team has significant industry experience and would be difficult to replace. We believe we are in a critical period of competition in the financial services and payments industry. The market for qualified individuals is highly competitive, and we may not be able to attract and retain qualified personnel or candidates to replace or succeed members of our senior management team or other key personnel or it may be expensive to do so. We may be subject to restrictions under future legislation or regulation limiting executive compensation. For example, the federal banking agencies have previously issued proposed rulemaking on incentive compensation practices for certain employees at banking organizations, including executives, and may issue additional rules relating to such activities in the future. These requirements could negatively impact our ability to compete with other companies in attracting, hiring and retaining key personnel and offer incentives that motivate our key personnel to perform and may require us to extensively restructure certain of our existing incentive compensation practices. Additionally, the market for individuals with skills in fields such as technology, analytics and payments is increasingly competitive and we may not be able to attract and retain persons with the desired skill set or experience. If we are unable to recruit, retain and motivate key personnel to manage and grow our business well, our business could be materially adversely affected.

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 December 31, 2019 and 2018 losses related to merchant chargebacks were not material.

Damage to our reputation could damage our business.

In recent years, financial services companies have experienced increased reputational risk as consumers protest and regulators scrutinize business and compliance practices of such companies. Maintaining a positive reputation is critical to attracting and retaining customers, investors and employees. Damage to our reputation can therefore cause significant harm to our business and prospects. Harm to our reputation can arise from numerous sources, including, among others, employee misconduct, a breach of our or our service providers' cybersecurity defenses, litigation or regulatory outcomes, failing to deliver minimum standards of service and quality, compliance failures, and the activities of customers, business partners and counterparties. Social media also can cause harm to our reputation. By its very

nature, social media can reach a wide audience in a very short amount of time, which presents unique corporate communications challenges. Negative or 'wrong' type of publicity generated through unexpected social media coverage can damage Discover's reputation and brand. Negative publicity regarding us, whether or not true, may result in customer attrition and other harm to our business prospects.

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

The Discover, PULSE and Diners Club brands have substantial economic and goodwill value. Our success is dependent on our ability to promote and protect these brands and our other intellectual property. Our ability to attract and retain customers is highly dependent upon the external perception of our company and brands. Our brands are licensed for use to business partners and network participants, some of whom have contractual obligations to promote and develop our brands. For example, the Discover card brand is now being issued by certain Diners Club licensees in their local markets. If our business partners do not adhere to contractual standards, engage in improper business practices, or otherwise misappropriate, use or diminish the value of our brands or our other intellectual property, we may suffer reputational and financial damage. If we will not be able to adequately protect our brands, our proprietary information and other intellectual property, our business success may 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, technology development expenses or licensing fees, and we may have to alter our business practices or be prevented from competing effectively.

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

We must comply with an array of banking, consumer lending, and payment services laws and regulations in all of the jurisdictions in which we operate as described more fully in "Business — Supervision and Regulation" and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments." Regulatory developments and supervisory findings and ratings could negatively impact our business strategies or require us to: limit or change our business practices, restructure our products in ways that we may not currently anticipate, limit our product offerings, invest more management time and resources in compliance efforts, limit the fees we can charge for services, or limit our ability to pursue certain business opportunities and obtain related required regulatory approvals. For additional information regarding bank regulatory limitations on acquisitions and investments, see "Business — Supervision and Regulation — Acquisitions and Investments." See Note 19: Litigation and Regulatory Matters to our consolidated financial statements for more information on recent matters affecting Discover and the second risk factor in this section regarding the regulatory environment for the businesses in which we engage.

In addition, we are subject to inquiries and enforcement actions from states' attorney general offices and 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. We also are subject to the requirements of entities that set and interpret the accounting standards (such as the Financial Accounting Standards Board ("FASB"), the SEC, banking regulators and our independent registered public accounting firm), which may add new requirements or change their interpretations on how standards should be applied. In June 2016, the FASB issued a new accounting standard that requires lenders to adopt the current expected credit loss ("CECL") approach to evaluate impairment of loans and financial instruments. The CECL approach, which replaces the incurred loss model, requires evaluation of credit impairment based on an estimate of life of loan losses. The CECL standard is effective January 1, 2020. See Note 1: Background and Basis of Presentation to our consolidated financial statements for more information on the new standard and its impact at adoption. Other guidance not yet issued could potentially have a material impact on business lines, as well as how we record and report our financial condition and results of operations, and could have an impact on regulatory capital.

Failure to comply with laws, regulations and standards could lead to adverse consequences such as financial, structural, reputational and operational penalties, including receivership, litigation exposure, disgorgement and fines, (as described further below). For example, failure to comply with anti-corruption laws, including the Foreign Corrupt Practices Act and other laws regarding corporate conduct, can expose us and/or individual employees to potentially severe criminal and civil penalties.

Legislative, regulatory and tax code changes could impact the profitability of our business activities, alter consumer behavior in ways we did not anticipate, require us to limit or change our business practices or our product

offerings, or 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 competitors or may disproportionately benefit our competitors.

Current and proposed laws and regulations addressing consumer privacy and data use and security could affect the competitiveness of our products and increase our costs.

Legal or regulatory pronouncements relating to consumer privacy, data use and security affect our business. We are subject to a number of laws concerning consumer privacy and data use and security such as the European Union's General Data Privacy Regulation and the California Consumer Privacy Act. Due to recent consumer data compromise events in the United States, which resulted in unauthorized access to millions of customers' data, these areas continue to be a focus of the executive administration, Congress, state legislators and attorneys general and other regulators. Developments in this area, such as new laws, regulations, regulatory guidance, litigation or enforcement actions, could result in new or different requirements on Discover and other card issuers or networks that could increase costs or adversely affect the competitiveness of our credit card or debit card products. See the discussion on recent security developments in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments" for more information. 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 or the failure to provide timely notification of a disclosure, could result in litigation, 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 consumer banking and payment services industries have historically been subject to significant legal actions, including class action lawsuits and commercial, shareholder and patent litigation. Many of these actions have included claims for substantial compensatory, statutory or punitive damages. We have historically offered customers an arbitration clause in agreements to quickly and economically resolve disputes. The arbitration clause has, in some cases, also limited our exposure to consumer class action litigation, however, there can be no assurance that we will be able to continue to offer arbitration clauses in the future or that we will be successful in enforcing the arbitration clause. Legal challenges to the enforceability of these clauses have led most card issuers, and may cause us, to discontinue their use. There have previously been bills pending in Congress to directly or indirectly prohibit the use of pre-dispute arbitration clauses in some or all consumer banking products. Further, from time to time, we are involved in legal actions challenging the use of our arbitration clause. In addition, we have been and may again be involved in various actions or proceedings brought by governmental regulatory and enforcement agencies, which could harm our reputation, require us to change our business activities and product offerings, or subject us to significant fines, penalties, customer restitution or other requirements, resulting in increased expenses. For example, complying with our agreements with the Federal Reserve and the FDIC consent order related to our anti-money laundering program have caused us to incur significant expenses. See Note 19: Litigation and Regulatory Matters to our consolidated financial statements for more information on current matters affecting Discover.

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," "would" 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:

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- 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, the levels of consumer confidence and consumer debt, and investor sentiment;
- the impact of current, pending and future legislation, regulation, supervisory guidance, and regulatory and legal actions, including, but not limited to, those related to accounting guidance, tax reform, financial regulatory reform, consumer financial services practices, anti-corruption and funding, capital and liquidity;
- the actions and initiatives of current and potential competitors;
- our ability to manage our expenses;
- our ability to successfully achieve card acceptance across our networks and maintain relationships with network participants and merchants;
- our ability to sustain and grow our card, private student loan and personal loan products;
- our ability to increase or sustain Discover card usage or attract new customers;
- difficulty obtaining regulatory approval for, financing, closing, transitioning, integrating or managing the expenses of acquisitions of or investments in new businesses, products or technologies;
- our ability to manage our credit risk, market risk, liquidity risk, operational risk, compliance and legal risk, and strategic risk;
- the availability and cost of funding and capital;
- access to deposit, securitization, equity, debt and credit markets;
- the impact of rating agency actions;
- the level and volatility of equity prices, commodity prices and interest rates, currency values, investments, other market fluctuations and other market indices;
- losses in our investment portfolio;
- limits on our ability to pay dividends and repurchase our common stock;
- limits on our ability to receive payments from our subsidiaries;
- fraudulent activities or material security breaches of our or others' key systems;
- our ability to remain organizationally effective;
- the effect of political, economic and market conditions, geopolitical events and unforeseen or catastrophic events;
- our ability to introduce new products or services;
- our ability to manage our relationships with third-party vendors;
- our ability to maintain current technology and integrate new and acquired systems and technology;
- 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; and
- new lawsuits, investigations or similar matters or unanticipated developments related to current matters.

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

Our principal properties are located in the United States and include our corporate headquarters, our call centers and a processing center. Our corporate headquarters is used by both our Direct Banking and Payment Services segments and the call centers and processing center largely support our Direct Banking segment. Our call centers and processing center are being utilized to a reasonable capacity. We believe our principal facilities are both suitable and adequate to meet our current and projected needs. We also have various offices located outside the United States that primarily support our Payment Services segment.

Item 3. Legal Proceedings

For a description of legal proceedings, see Note 19: Litigation and Regulatory Matters to our consolidated financial statements.

Item 4. Mine Safety Disclosures

None.

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

Our common stock is traded on the New York Stock Exchange (ticker symbol DFS). The approximate number of record holders of our common stock as of February 21, 2020 was 43,820.

Issuer Purchases of Equity Securities

The following table sets forth information regarding purchases of our common stock related to our share repurchase program and employee transactions that were made by us or on our behalf during the most recent quarter:

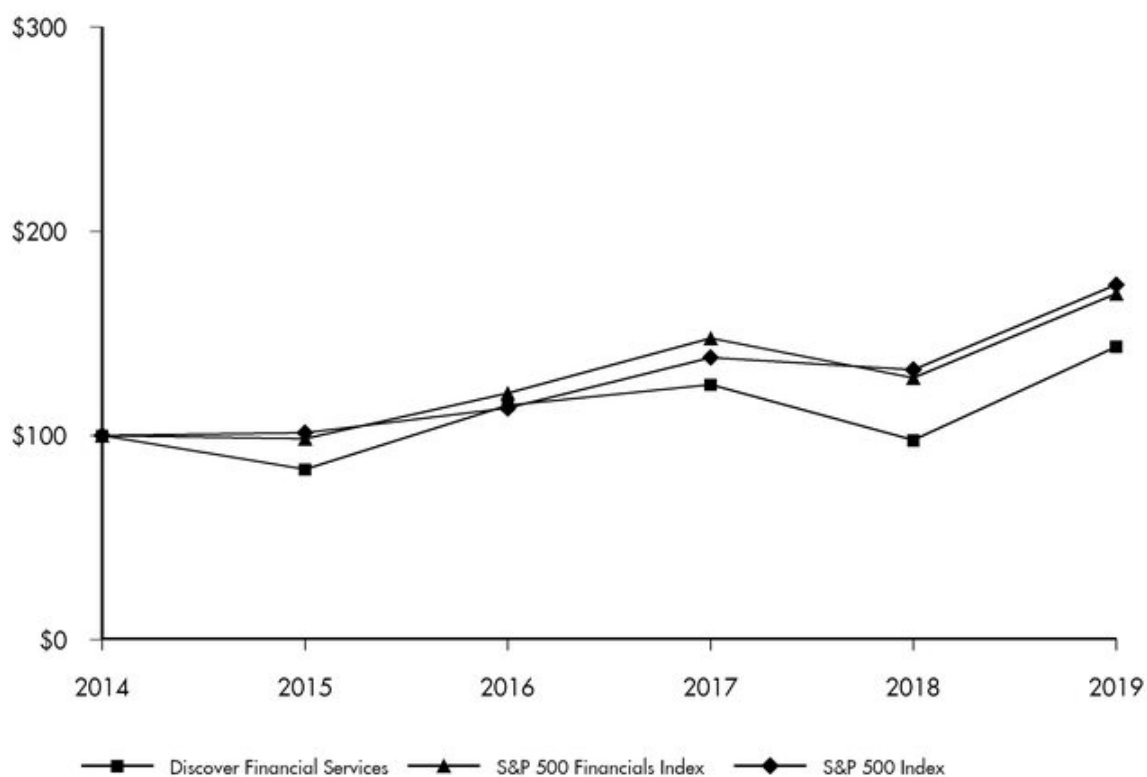
Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program ⁽¹⁾	Maximum Dollar Value of Shares that may yet be purchased under the Plans or Programs ⁽¹⁾
October 1-31, 2019				
Repurchase program ⁽¹⁾	1,844,472	\$ 79.03	1,844,472	\$ 1,722,576,910
Employee transactions ⁽²⁾	2,889	\$ 80.02	N/A	N/A
November 1-30, 2019				
Repurchase program ⁽¹⁾	1,508,652	\$ 83.39	1,508,652	\$ 1,596,764,800
Employee transactions ⁽²⁾	5,762	\$ 83.22	N/A	N/A
December 1-31, 2019				
Repurchase program ⁽¹⁾	1,507,559	\$ 85.19	1,507,559	\$ 1,468,338,670
Employee transactions ⁽²⁾	4,157	\$ 85.56	N/A	N/A
Total				
Repurchase program ⁽¹⁾	4,860,683	\$ 82.29	4,860,683	\$ 1,468,338,670
Employee transactions ⁽²⁾	12,808	\$ 83.25	N/A	N/A

(1) On July 18, 2019, our Board of Directors approved a share repurchase program authorizing the purchase of up to \$2.2 billion of our outstanding shares of common stock. This share repurchase program expires on September 30, 2020 and may be terminated at any time.

(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.

Stock Performance Graph

The following graph compares the cumulative total stockholder return of our common stock, the S&P 500 Financials Index and the S&P 500 Index for the period from December 31, 2014 through December 31, 2019. The graph assumes an initial investment of \$100 on December 31, 2014. The cumulative returns include stock price appreciation and assume full reinvestment of dividends. This graph does not forecast future performance



of our common stock.

	December 31,					
	2014	2015	2016	2017	2018	2019
Discover Financial Services	\$ 100.00	\$ 83.45	\$ 114.69	\$ 124.90	\$ 97.69	\$ 143.56
S&P 500 Financials Index	\$ 100.00	\$ 98.44	\$ 120.83	\$ 147.58	\$ 128.33	\$ 169.52
S&P 500 Index	\$ 100.00	\$ 101.37	\$ 113.49	\$ 138.26	\$ 132.19	\$ 173.80

Item 6. Selected Financial Data

The following table presents our selected financial data and operating statistics. The statement of income data for the years ended December 31, 2019, 2018 and 2017, and the statement of financial condition data as of December 31, 2019 and 2018 have been derived from our audited consolidated financial statements included elsewhere in this annual report on Form 10-K. The statement of income data for the years ended December 31, 2016 and 2015, and the statement of financial condition data as of December 31, 2017, 2016 and 2015 have been derived from audited consolidated financial statements not included elsewhere in this annual report on Form 10-K.

Discover Financial Services

Selected Financial Data

	For the Years Ended December 31,				
	2019	2018	2017	2016	2015
	(in millions, except per share amounts)				
Statement of Income Data					
Interest income	\$ 11,993	\$ 10,893	\$ 9,648	\$ 8,616	\$ 7,945
Interest expense	2,530	2,139	1,648	1,398	1,263
Net interest income	9,463	8,754	8,000	7,218	6,682
Other income	1,996	1,955	1,897	1,881	2,057
Revenue net of interest expense	11,459	10,709	9,897	9,099	8,739
Provision for loan losses	3,231	3,035	2,579	1,859	1,512
Other expense	4,393	4,077	3,781	3,584	3,615
Income before income tax expense	3,835	3,597	3,537	3,656	3,612
Income tax expense	878	855	1,438	1,263	1,315
Net income	<u>\$ 2,957</u>	<u>\$ 2,742</u>	<u>\$ 2,099</u>	<u>\$ 2,393</u>	<u>\$ 2,297</u>
Net income allocated to common stockholders	<u>\$ 2,908</u>	<u>\$ 2,689</u>	<u>\$ 2,031</u>	<u>\$ 2,339</u>	<u>\$ 2,246</u>
Statement of Financial Condition Data (as of)					
Loan receivables	\$ 95,894	\$ 90,512	\$ 84,248	\$ 77,254	\$ 72,385
Total assets	\$ 113,996	\$ 109,553	\$ 100,087	\$ 92,308	\$ 86,799
Total stockholders' equity	\$ 11,859	\$ 11,130	\$ 10,892	\$ 11,323	\$ 11,275
Allowance for loan losses	\$ 3,383	\$ 3,041	\$ 2,621	\$ 2,167	\$ 1,869
Long-term borrowings	\$ 25,701	\$ 27,228	\$ 26,326	\$ 25,443	\$ 24,650
Per Share of Common Stock					
Basic EPS from continuing operations	\$ 9.09	\$ 7.81	\$ 5.43	\$ 5.77	\$ 5.14
Diluted EPS from continuing operations	\$ 9.08	\$ 7.79	\$ 5.42	\$ 5.77	\$ 5.13
Weighted-average shares outstanding	320	344	374	405	437
Weighted-average shares outstanding (fully diluted)	320	345	374	406	437
Dividends declared per share of common stock	\$ 1.68	\$ 1.50	\$ 1.30	\$ 1.16	\$ 1.08
Common stock dividend payout ratio	18.48%	19.21%	23.94%	20.10%	21.01%
Ratios					
Return on average total equity	26%	25%	19%	21%	21%
Return on average assets	3%	3%	2%	3%	3%
Average stockholders' equity to average total assets	11%	11%	12%	13%	14%

Selected Financial Data (continued)

For the Years Ended December 31,

	2019	2018	2017	2016	2015
(dollars in millions)					
Selected Statistics					
Total Loan Receivables					
Loan receivables	\$ 95,894	\$ 90,512	\$ 84,248	\$ 77,254	\$ 72,385
Average loan receivables	\$ 90,886	\$ 85,256	\$ 78,525	\$ 72,280	\$ 69,061
Interest yield	12.72%	12.39%	12.06%	11.78%	11.40%
Net principal charge-off rate	3.17%	3.06%	2.70%	2.16%	2.01%
Delinquency rate (over 30 days) (excluding PCI)	2.40%	2.31%	2.20%	1.97%	1.67%
Delinquency rate (over 90 days) (excluding PCI)	1.15%	1.08%	0.99%	0.87%	0.76%
Credit Card Loans					
Credit card loan receivables	\$ 77,181	\$ 72,876	\$ 67,291	\$ 61,522	\$ 57,896
Average credit card loan receivables	\$ 72,740	\$ 67,953	\$ 62,079	\$ 57,238	\$ 54,846
Interest yield	13.32%	13.00%	12.74%	12.50%	12.08%
Net principal charge-off rate	3.43%	3.26%	2.91%	2.34%	2.22%
Delinquency rate (over 30 days)	2.62%	2.43%	2.28%	2.04%	1.72%
Delinquency rate (over 90 days)	1.32%	1.22%	1.12%	0.97%	0.85%
Personal Loans					
Personal loan receivables	\$ 7,687	\$ 7,454	\$ 7,374	\$ 6,481	\$ 5,490
Average personal loan receivables	\$ 7,522	\$ 7,423	\$ 7,020	\$ 5,895	\$ 5,245
Interest yield	13.07%	12.60%	12.25%	12.19%	12.04%
Net principal charge-off rate	4.28%	4.15%	3.30%	2.55%	2.15%
Delinquency rate (over 30 days)	1.37%	1.60%	1.40%	1.12%	0.89%
Delinquency rate (over 90 days)	0.40%	0.47%	0.41%	0.29%	0.27%
Private Student Loans (excluding PCI)					
Private student loan receivables	\$ 8,402	\$ 7,728	\$ 7,076	\$ 6,393	\$ 5,647
Average private student loan receivables	\$ 8,124	\$ 7,441	\$ 6,764	\$ 6,042	\$ 5,272
Interest yield	8.59%	8.25%	7.72%	7.35%	7.16%
Net principal charge-off rate	0.85%	1.14%	1.21%	1.10%	1.07%
Delinquency rate (over 30 days)	1.72%	2.00%	2.35%	2.22%	1.91%
Delinquency rate (over 90 days)	0.42%	0.49%	0.47%	0.55%	0.43%

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our audited consolidated financial statements and related notes included elsewhere in this annual report on Form 10-K. Some of the information contained in this discussion and analysis constitutes forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this annual report on Form 10-K particularly under "Risk Factors" and "Special Note Regarding Forward-Looking Statements," which immediately follows "Risk Factors." Unless otherwise specified, references to Notes to our consolidated financial statements are to the Notes to our audited consolidated financial statements as of December 31, 2019 and 2018 and for years ended December 31, 2019, 2018 and 2017.

Introduction and Overview

Discover Financial Services ("DFS") is a direct banking and payment services company. We provide direct banking products and services and payment services through our subsidiaries. We offer our customers credit card loans, private student loans, personal loans, home equity loans and deposit products. We also operate the Discover Network, the PULSE network ("PULSE") and Diners Club International ("Diners Club"). The Discover Network processes transactions for Discover-branded credit and debit cards and 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 merchant acceptance 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.

Our primary revenues consist of interest income earned on loan receivables and fees earned from customers, financial institutions, 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 and networks. Our business activities are funded primarily through consumer deposits, securitization of loan receivables and the issuance of unsecured debt.

2019 Highlights

The highlights below compare results as of and for the year ended December 31, 2019 against results for the year ended December 31, 2018.

- Net income was \$3.0 billion, or \$9.08 per diluted share, compared to \$2.7 billion, or \$7.79 per diluted share, in the prior year.
- Total loans grew \$5.4 billion, or 6%, to \$95.9 billion.
- Credit card loans grew \$4.3 billion, or 6%, to \$77.2 billion.
- The total net charge-off rate increased 11 basis points to 3.17%.
- The net charge-off rate for credit card loans increased 17 basis points to 3.43% and the delinquency rate for credit card loans over 30 days past due increased 19 basis points to 2.62%.
- Direct-to-consumer deposits grew \$9.7 billion, or 22%, to \$54.4 billion.
- Payment Services transaction volume for the segment was \$251.4 billion, up 8%.

Outlook

The outlook below provides our expectations for our business, reflective of our assumption that the U.S. economy will remain stable in 2020.

- We continue to focus on disciplined capital deployment through profitable organic loan growth and execution of our capital plan.
- Our marketing strategy is focused on adding new accounts to achieve continued loan growth. For credit cards, we are also focused on increasing utilization with existing customers.
- Total expenses are expected to increase reflecting continued investment in brand awareness and technological capabilities.

- We will continue to pursue payments volume growth and leverage our network to support our card-issuing business.
- We expect the total net charge-off rate to increase primarily due to the seasoning of recent loan growth.
- Adoption of the current expected credit loss (“CECL”) approach will increase the allowance for loan losses. Going forward, the seasonality of our business will likely impact quarterly reserve changes and could increase volatility from one quarter to the next.

Regulatory Environment and Developments

Policymakers continue to develop, implement and execute on regulatory, supervisory and enforcement priorities. The impact of the evolving regulatory environment on our business and operations depends upon a number of factors, including the actions of policymakers at the federal and state levels, our competitors, and consumers. For more information on how the regulatory and supervisory environment, ongoing enforcement actions and findings, and changes to laws and regulations could impact our strategies, the value of our assets, or otherwise adversely affect our business see “Risk Factors — Current Economic and Regulatory Environment.” For more information on recent matters affecting us, see Note 19: Litigation and Regulatory Matters to our consolidated financial statements.

Federal banking regulators continue to propose and implement new regulations and supervisory guidance, and modify their examination and enforcement priorities. In May 2018, the President signed into law the Economic Growth, Regulatory Relief, and Consumer Protection Act, which is intended to promote economic growth, provide tailored regulatory relief for smaller and less complex financial institutions, and enhance consumer protections. Among other provisions, the law raised the asset threshold for automatically designating a bank holding company as “systemically important” from \$50 billion to \$250 billion so that bank holding companies with assets below \$250 billion are no longer automatically subject to enhanced prudential standards pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which created a framework for regulation of large financial firms, including Discover.

In October 2019, the federal banking regulators approved final rules that will tailor existing regulatory requirements related to capital, liquidity and enhanced prudential standards to an institution’s risk and complexity profile for banking institutions with total consolidated assets of \$100 billion or more. Under the final rules, Discover is categorized as a Category IV institution and therefore subject to the least stringent requirements for bank holding companies with at least \$100 billion in assets. Among other things, Discover will be subject to supervisory stress tests every other year rather than annually, will no longer be subject to regulations requiring submission of company-run capital stress tests and will no longer be subject to the liquidity coverage ratio. Discover will however still be required to submit annual capital plans to the Federal Reserve and will remain subject to other core components of the enhanced prudential standards rules, such as risk management and risk committee requirements and liquidity risk management regulations. The final rules took effect on December 31, 2019. The final rules did not address other aspects of the Federal Reserve’s capital plan rule or the Comprehensive Capital Analysis and Review (“CCAR”) framework. These requirements, including the previously proposed “stress capital buffer” framework, are expected to be addressed in a forthcoming rulemaking from the Federal Reserve. We have been notified that we are subject to the CCAR quantitative process in 2020.

Policymakers at the federal and state levels are increasingly focused on measures to enhance data security and data breach incident response requirements. Furthermore, regulations and legislation at various levels of government have been proposed and enacted to augment data privacy standards. For example, the California Consumer Privacy Act (“CCPA”) creates a broad set of privacy rights and remedies modeled in part on the European Union’s General Data Protection Regulation. The CCPA went into effect on January 1, 2020, and proposed regulations have yet to be finalized. The original proponent of the CCPA recently launched a 2020 California ballot initiative with the goal of expanding the rights and remedies created by the CCPA, while protecting the new law from future legislative amendments. While it is too early to determine the full impact of these developments, they may result in the imposition of requirements on Discover and other providers of consumer financial services or networks that could adversely affect our businesses.

Banking

Current Expected Credit Loss

In June 2016, the Financial Accounting Standards Board issued Accounting Standards Update No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which is

effective for us on January 1, 2020. The standard alters accounting principles generally accepted in the United States (“GAAP”) by replacing the incurred loss model with the CECL approach. The CECL approach requires our allowance for loan losses to be based on an estimate of all expected credit losses over the remaining contractual term of all of the loans, as opposed to an estimate of incurred losses as of the balance sheet date. Refer to Note 1: Background and Basis of Presentation to our consolidated financial statements for details on the impact of adoption on January 1, 2020.

In December 2018, federal banking agencies adopted a joint final rule that will, among other things, give bank holding companies and banks, including Discover and its bank subsidiaries, the option to phase in the regulatory capital impacts of implementing CECL over a three-year transition period. Additionally, notwithstanding the January 1, 2020 effective date, the Federal Reserve announced that it will not incorporate CECL into its supervisory stress tests until at least 2022 to reduce uncertainty, allow for better capital planning at affected firms and allow the Federal Reserve to gather additional information on the impact of CECL; however, banking institutions subject to Dodd-Frank Act company-run stress test requirements are required to incorporate CECL into their internal stress testing processes beginning in 2020. We anticipate that DFS and Discover Bank will continue to meet requirements to be “well-capitalized” upon adoption of the standard. For more information on CECL, see Note 1: Background and Basis of Presentation to our consolidated financial statements.

LIBOR

On July 27, 2017, the UK Financial Conduct Authority announced that it would no longer encourage or compel banks to continue to contribute quotes and maintain the London Interbank Offered Rate (“LIBOR”) after 2021. LIBOR is commonly used as a benchmark to determine interest rates for financial instruments, such as floating-rate asset-backed securities issued by Discover Card Execution Note Trust, and certain financial products, including some of our floating-rate student loans. A cross-functional team is overseeing and managing our transition away from the use of LIBOR. This team monitors developments associated with LIBOR alternatives and evolving industry and marketplace norms and conventions for LIBOR indexed instruments, evaluates the impact that the inability to determine LIBOR after 2021 will have on us, and facilitates the operational changes associated with the use of alternative benchmark rates.

Consumer Financial Services

The Consumer Financial Protection Bureau (the “CFPB”) regulates consumer financial products and services, and examines certain providers of consumer financial products and services, including Discover. The CFPB’s authority includes preventing “unfair, deceptive or abusive acts or practices” and ensuring that consumer have access to fair, transparent and competitive financial products and services. The CFPB has rulemaking, supervision and enforcement powers with respect to federal consumer protection laws. Historically, the CFPB’s policy priorities focused on several financial products of the type we offer (e.g. credit cards and student loans). In addition, the CFPB is required by statute to undertake certain actions including its bi-annual review of the consumer credit card market.

The current CFPB Director has indicated that the CFPB will focus on the prevention of harm, establishing valid metrics for success, and creating a level playing field for all financial institutions. Additionally, with regards to the CFPB’s rulemaking and enforcement activities, the Director has outlined a framework that seeks to foster a more transparent rulemaking process that incorporates a robust cost benefit analysis, applies supervisory practices consistently, and ensures that due process is a critical component of enforcement activity.

Payment Networks

The Dodd-Frank Act contains several provisions impacting the debit card market, including network participation requirements and interchange fee limitations. The changing debit card environment, including competitor actions related to merchant and acquirer pricing and transaction routing strategies, has adversely affected, and is expected to continue to adversely affect, our PULSE network’s business practices, network transaction volume, revenue and prospects for future growth. We continue to closely monitor competitor pricing and technology development strategies in order to assess their impact on our business and on competition in the marketplace. Following an inquiry by the U.S. Department of Justice into some of these competitor pricing strategies, PULSE filed a lawsuit against Visa in late 2014 with respect to these competitive concerns. The Court granted summary judgment in favor of Visa in August 2018. PULSE filed an appeal on January 17, 2019 and Visa filed their response to the appeal on April 5, 2019. The Fifth Circuit Court of Appeals held a hearing on the appeal October 9, 2019. Visa also faces ongoing merchant litigation as it relates to the underlying anticompetitive behavior that is the subject of PULSE’s case against Visa. In addition, the Dodd-Frank Act’s network participation requirements impact PULSE’s ability to enter into exclusivity arrangements, which affects PULSE’s current business practices and may materially adversely affect its network transaction volume and revenue.

Results of Operations

The discussion below provides a summary of our results of operations and information about our loan receivables as of and for the year ended December 31, 2019 compared to the year ended December 31, 2018. Refer to our annual report on Form 10-K for the year ended December 31, 2018 for discussion of our results of operations and loan receivables information as of and for the year ended December 31, 2018 compared to the year ended December 31, 2017.

Segments

We manage our business activities in two segments, Direct Banking and Payment Services, based on the products and services provided. For a detailed description of the operations of each segment, as well as the allocation conventions used in our business segment reporting, see Note 22: Segment Disclosures to our consolidated financial statements.

The following table presents segment data (dollars in millions):

	For the Years Ended December 31,		
	2019	2018	2017
Direct Banking			
Interest income			
Credit card	\$ 9,690	\$ 8,835	\$ 7,907
Private student loans	698	614	523
PCI student loans	119	139	159
Personal loans	983	935	860
Other	502	369	199
Total interest income	11,992	10,892	9,648
Interest expense	2,530	2,139	1,648
Net interest income	9,462	8,753	8,000
Provision for loan losses	3,233	3,035	2,586
Other income	1,648	1,645	1,607
Other expense	4,231	3,918	3,629
Income before income tax expense	3,646	3,445	3,392
Payment Services			
Net interest income	1	1	—
Provision for loan losses	(2)	—	(7)
Other income	348	310	290
Other expense	162	159	152
Income before income tax expense	189	152	145
Total income before income tax expense	\$ 3,835	\$ 3,597	\$ 3,537

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

	For the Years Ended December 31,		
	2019	2018	2017
Network Transaction Volume			
PULSE Network	\$ 192,067	\$ 179,792	\$ 157,128
Network Partners	25,368	18,948	14,213
Diners Club ⁽¹⁾	33,967	33,877	31,544
Total Payment Services	251,402	232,617	202,885
Discover Network—Proprietary ⁽²⁾	151,243	143,865	133,044
Total Volume	\$ 402,645	\$ 376,482	\$ 335,929
Transactions Processed on Networks			
Discover Network	2,717	2,469	2,240
PULSE Network	4,788	4,364	3,856
Total	7,505	6,833	6,096
Credit Card Volume			
Discover Card Volume ⁽³⁾	\$ 160,283	\$ 152,826	\$ 141,858
Discover Card Sales Volume ⁽⁴⁾	\$ 146,183	\$ 139,031	\$ 128,806

(1) 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 Discover card sales volume on the Discover Network.

(3) Represents Discover card activity related to sales net of returns, balance transfers, cash advances and other activity.

(4) Represents Discover card activity related to sales net of returns.

Direct Banking

Our Direct Banking segment reported pretax income of \$3.6 billion for the year ended December 31, 2019 as compared to \$3.4 billion for the year ended December 31, 2018.

Net interest income increased for the year ended December 31, 2019 as compared to the year ended December 31, 2018 primarily driven by loan growth and higher yields on credit card loans, partially offset by higher funding costs. Interest income increased over the prior year due to continued loan growth and yield expansion resulting from higher average market rates and changes in portfolio mix. Interest expense increased compared to the prior year due to a larger funding base and higher average market rates.

For the year ended December 31, 2019, the provision for loan losses increased as compared to the year ended December 31, 2018 primarily due to higher levels of net charge-offs, slightly offset by lower reserve builds. For a detailed discussion on provision for loan losses, see “— Loan Quality — Provision and Allowance for Loan Losses.”

Other income for the Direct Banking segment was relatively flat for the year ended December 31, 2019 as compared to the year ended December 31, 2018.

Other expense increased for the year ended December 31, 2019 as compared to the year ended December 31, 2018 primarily due to higher employee compensation and benefits, professional fees, and information processing and communications. Employee compensation and benefits increased as a result of higher average salaries. The increase in professional fees was primarily driven by higher collection fees resulting from increased recoveries, as well as investments in technological capabilities. Information processing and communications was higher due to continued investment in infrastructure and analytic capabilities.

Discover card sales volume was \$146.2 billion for the year ended December 31, 2019, which was an increase of 5.1% as compared to the year ended December 31, 2018. This volume growth was primarily driven by higher consumer spending.

Payment Services

Our Payment Services segment reported pretax income of \$189 million for the year ended December 31, 2019 as compared to pretax income of \$152 million for the year ended December 31, 2018. The increase in segment pretax income was primarily due to higher transaction volume across multiple channels.

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 effect on our consolidated results of operations and, in certain cases, could have a material effect on our consolidated financial condition. Management has identified the estimates related to our allowance for loan losses, the evaluation of goodwill for potential impairment and the accrual of income taxes as critical accounting estimates.

Allowance for Loan Losses

We base our allowance for loan losses on several analyses that help us estimate incurred losses as of the balance sheet date. In deriving this estimate, we consider the collectibility of principal, interest and fees associated with our loan receivables. While our estimation process includes historical data and analysis, there is a significant amount of judgment applied in selecting inputs and analyzing the results produced to determine the allowance. We use a migration analysis to estimate the likelihood that a loan will progress through the various stages of delinquency. Management also estimates loss emergence by using other analyses to estimate losses incurred from non-delinquent accounts. The considerations in these analyses include past and current loan performance, loan seasoning and growth, current risk management practices, account collection strategies, economic conditions, bankruptcy filings, policy changes and forecasting uncertainties. Given the same information, others may reach different reasonable estimates.

If management used different assumptions in estimating incurred net loan 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 incurred net loan losses could have resulted in a change of approximately \$338 million in the allowance for loan losses at December 31, 2019, with a corresponding change in the provision for loan losses. See "— Loan Quality" and Note 2: Summary of Significant Accounting Policies to our consolidated financial statements for further details about our allowance for loan losses.

Goodwill

We recognize goodwill when the purchase price of an acquired business exceeds the total of the fair values of the acquired net assets. As required by GAAP, we test goodwill for impairment annually, or more often if indicators of impairment exist. In evaluating goodwill for impairment, management must estimate the fair value of the reporting 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 reporting units. 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, capital expenditures, discount rates and other assumptions that are judgmental in nature.

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At December 31, 2019, we reported goodwill of \$255 million associated with our PULSE network. The estimated fair value of the PULSE reporting unit was more than six times its carrying value as of October 1, 2019, and there are no present conditions that we believe would cause the fair value of this reporting unit to fall below its carrying value. However, competitive pressures leading to significant declines in revenue, significant increases in the cost of equity, deteriorating economic conditions, or other events adversely impacting the assumptions used by management in the valuation, could cause the fair value of the reporting unit or the associated goodwill to decline in the future, which could result in an impairment loss. At December 31, 2019, based on the annual impairment testing performed, there was no impairment identified. See Note 7: Goodwill and Intangible Assets to our consolidated financial statements for further details about goodwill and the related impairment testing.

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, such as the recent rate change enacted with the Tax Cuts and Jobs Act of 2017, the effect on our consolidated financial condition and results of operations can be significant. See Note 15: Income Taxes to our consolidated financial statements for additional information about income taxes.

Earnings Summary

The following table outlines changes in our consolidated statements of income (dollars in millions):

	For the Years Ended December 31,			2019 vs. 2018 Increase		2018 vs. 2017 Increase (Decrease)	
	2019	2018	2017	\$	%	\$	%
Interest income	\$ 11,993	\$ 10,893	\$ 9,648	\$ 1,100	10%	\$ 1,245	13 %
Interest expense	2,530	2,139	1,648	391	18%	491	30 %
Net interest income	9,463	8,754	8,000	709	8%	754	9 %
Provision for loan losses	3,231	3,035	2,579	196	6%	456	18 %
Net interest income after provision for loan losses	6,232	5,719	5,421	513	9%	298	5 %
Other income	1,996	1,955	1,897	41	2%	58	3 %
Other expense	4,393	4,077	3,781	316	8%	296	8 %
Income before income tax expense	3,835	3,597	3,537	238	7%	60	2 %
Income tax expense	878	855	1,438	23	3%	(583)	(41)%
Net income	<u>\$ 2,957</u>	<u>\$ 2,742</u>	<u>\$ 2,099</u>	<u>\$ 215</u>	8%	<u>\$ 643</u>	31 %

Net Interest Income

The tables that follow this section have been provided to supplement the discussion below and provide further analysis of net interest income, net interest margin and the impact of rate and volume changes on net interest income. Net interest income represents the difference between interest income earned on our interest-earning assets and the interest expense incurred to finance those assets. We analyze net interest income in total by calculating net interest margin (net interest income as a percentage of average total loan receivables) and net yield on interest-earning assets (net interest income as a percentage of average total interest-earning assets). We also separately consider the impact of the level of loan receivables and the related interest yield and the impact of the cost of funds related to each of our funding sources, along with the income generated by our liquidity portfolio, on net interest income.

Our interest-earning assets consist of: (i) cash and cash equivalents primarily related to amounts on deposit with the Federal Reserve Bank of Philadelphia, (ii) restricted cash, (iii) other short-term investments, (iv) investment securities and (v) loan receivables. Our interest-bearing liabilities consist primarily of deposits, both direct-to-consumer and brokered, and long-term borrowings, including amounts owed to securitization investors. Net interest income is influenced by the following:

- The level and composition of loan receivables, including the proportion of credit card loans to other loans, as well as the proportion of loan receivables bearing interest at promotional rates as compared to standard rates;
- The credit performance of our loans, particularly with regard to charge-offs of finance charges, which reduce interest income;
- The terms of long-term borrowings and certificates of deposit upon initial offering, including maturity and interest rate;
- The interest rates necessary to attract and maintain direct-to-consumer deposits;
- The level and composition of other interest-earning assets, including our liquidity portfolio and interest-bearing liabilities;
- Changes in the interest rate environment, including the levels of interest rates and the relationships among interest rate indices, such as the prime rate, the Federal Funds rate, interest rate on excess reserves and LIBOR;
- The effectiveness of interest rate swaps in our interest rate risk management program; and
- The difference between the carrying amount and future cash flows expected to be collected on purchased credit-impaired ("PCI") loans.

Net interest income increased for the year ended December 31, 2019 as compared to the year ended December 31, 2018 primarily driven by loan growth and higher yields on credit card loans, partially offset by higher funding costs. Interest income increased over the prior year due to continued loan growth and yield expansion resulting from higher average market rates and changes in portfolio mix. Interest expense increased compared to the prior year due to a larger funding base and higher average market rates.

Average Balance Sheet Analysis

(dollars in millions)

	For the Years Ended December 31,								
	2019			2018			2017		
	Average Balance	Yield/Rate	Interest	Average Balance	Yield/Rate	Interest	Average Balance	Yield/Rate	Interest
Assets									
Interest-earning assets									
Cash and cash equivalents	\$ 9,667	2.27%	\$ 219	\$ 14,494	1.93%	\$ 280	\$ 13,300	1.11%	\$ 148
Restricted cash	620	2.24%	14	633	1.85%	12	625	0.97%	6
Other short-term investments	754	2.66%	20	—	—%	—	—	—%	—
Investment securities	7,603	2.35%	179	1,910	2.08%	40	1,667	1.60%	27
Loan receivables(1)									
Credit card(2)	72,740	13.32%	9,690	67,953	13.00%	8,835	62,079	12.74%	7,907
Personal loans	7,522	13.07%	983	7,423	12.60%	936	7,020	12.25%	860
Private student loans	8,124	8.59%	698	7,441	8.25%	614	6,764	7.72%	522
PCI student loans	1,435	8.29%	119	1,846	7.54%	139	2,326	6.84%	159
Other	1,065	6.63%	71	593	6.28%	37	336	5.56%	19
Total loan receivables	90,886	12.72%	11,561	85,256	12.39%	10,561	78,525	12.06%	9,467
Total interest-earning assets	109,530	10.95%	11,993	102,293	10.65%	10,893	94,117	10.25%	9,648
Allowance for loan losses	(3,167)			(2,776)			(2,335)		
Other assets	4,627			4,324			4,189		
Total assets	\$ 110,990			\$ 103,841			\$ 95,971		
Liabilities and Stockholders' Equity									
Interest-bearing liabilities									
Interest-bearing deposits									
Time deposits(3)	\$ 33,870	2.57%	869	\$ 31,236	2.22%	695	\$ 27,123	1.91%	519
Money market deposits(4)	7,069	2.09%	148	6,798	1.81%	123	6,799	1.29%	88
Other interest-bearing savings deposits	28,209	2.02%	570	23,886	1.76%	420	20,155	1.18%	239
Total interest-bearing deposits(5)	69,148	2.30%	1,587	61,920	2.00%	1,238	54,077	1.56%	846
Borrowings									
Short-term borrowings	1	2.33%	—	2	2.07%	—	2	1.10%	—
Securitized borrowings(3)(4)	14,572	2.92%	425	16,218	2.67%	433	16,746	2.26%	379
Other long-term borrowings(3)	11,060	4.68%	518	10,231	4.57%	468	9,767	4.33%	423
Total borrowings	25,633	3.68%	943	26,451	3.41%	901	26,515	3.02%	802
Total interest-bearing liabilities	94,781	2.67%	2,530	88,371	2.42%	2,139	80,592	2.04%	1,648
Other liabilities and stockholders' equity	16,209			15,470			15,379		
Total liabilities and stockholders' equity	\$ 110,990			\$ 103,841			\$ 95,971		
Net interest income			\$ 9,463			\$ 8,754			\$ 8,000
Net interest margin(6)		10.41%			10.27%			10.19%	
Net yield on interest-earning assets(7)		8.64%			8.56%			8.50%	
Interest rate spread(8)		8.28%			8.23%			8.21%	

- (1) Average balances of loan receivables include non-accruing loans, which are included in the yield calculations. If the non-accruing loan balances were excluded, there would not be a material impact on the amounts reported above.
- (2) Interest income on credit card loans includes \$281 million, \$241 million and \$218 million of amortization of balance transfer fees for the years ended December 31, 2019, 2018 and 2017, respectively.
- (3) Includes the impact of interest rate swap agreements used to change a portion of fixed-rate funding to floating-rate funding.
- (4) Includes the impact of interest rate swap agreements used to change a portion of floating-rate funding to fixed-rate funding.
- (5) Includes the impact of Federal Deposit Insurance Corporation ("FDIC") insurance premiums and Large Institution Surcharge. As of October 2018, the FDIC no longer assesses a Large Institution Surcharge.
- (6) Net interest margin represents net interest income as a percentage of average total loan receivables.
- (7) Net yield on interest-earning assets represents net interest income as a percentage of average total interest-earning assets.
- (8) Interest rate spread represents the difference between the rate on total interest-earning assets and the rate on total interest-bearing liabilities.

Rate/Volume Variance Analysis⁽¹⁾

(dollars in millions)

	Year Ended December 31, 2019 vs. Year Ended December 31, 2018			Year Ended December 31, 2018 vs. Year Ended December 31, 2017		
	Volume	Rate	Total	Volume	Rate	Total
(Decrease)/Increase in net interest income due to changes in						
Interest-earning assets						
Cash and cash equivalents	\$ (104)	\$ 43	\$ (61)	\$ 15	\$ 117	\$ 132
Restricted cash	—	2	2	—	6	6
Other short-term investments	20	—	20	—	—	—
Investment securities	133	6	139	4	9	13
Loan receivables						
Credit card	634	221	855	763	165	928
Personal loans	12	35	47	51	25	76
Private student loans	58	26	84	54	38	92
PCI student loans	(33)	13	(20)	(35)	15	(20)
Other	31	3	34	15	3	18
Total loan receivables	702	298	1,000	848	246	1,094
Total interest income	751	349	1,100	867	378	1,245
Interest-bearing liabilities						
Interest-bearing deposits						
Time deposits	61	113	174	85	91	176
Money market deposits	5	20	25	—	35	35
Other interest-bearing savings deposits	83	67	150	49	132	181
Total interest-bearing deposits	149	200	349	134	258	392
Borrowings						
Securitized borrowings	(46)	38	(8)	(13)	67	54
Other long-term borrowings	38	12	50	21	24	45
Total borrowings	(8)	50	42	8	91	99
Total interest expense	141	250	391	142	349	491
Net interest income	\$ 610	\$ 99	\$ 709	\$ 725	\$ 29	\$ 754

(1) The rate/volume variance for each category has been allocated on a consistent basis between rate and volume variances between the years ended December 31, 2019, 2018 and 2017 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 millions):

	December 31,				
	2019	2018	2017	2016	2015
Credit card loans	\$ 77,181	\$ 72,876	\$ 67,291	\$ 61,522	\$ 57,896
Other loans					
Personal loans	7,687	7,454	7,374	6,481	5,490
Private student loans	8,402	7,728	7,076	6,393	5,647
Other	1,373	817	423	274	236
Total other loans	17,462	15,999	14,873	13,148	11,373
PCI loans ⁽¹⁾	1,251	1,637	2,084	2,584	3,116
Total loan receivables	95,894	90,512	84,248	77,254	72,385
Allowance for loan losses	(3,383)	(3,041)	(2,621)	(2,167)	(1,869)
Net loan receivables	<u>\$ 92,511</u>	<u>\$ 87,471</u>	<u>\$ 81,627</u>	<u>\$ 75,087</u>	<u>\$ 70,516</u>

(1) Represents PCI private student loans. See Note 4: Loan Receivables to our consolidated financial statements for more information regarding PCI loans.

Provision and Allowance for Loan Losses

Provision for loan losses is the expense related to maintaining the allowance for loan losses at an appropriate level to absorb the estimated probable losses in the loan portfolio at each period end date. While establishing the estimate for probable losses requires significant management judgment, the factors that influence the provision for loan losses include:

- The impact of general economic conditions on the consumer, including national and regional conditions, unemployment levels, bankruptcy trends and interest rate movements;
- Changes in consumer spending, payment and credit utilization behaviors;
- Changes in our loan portfolio, including the overall mix of accounts, products and loan balances within the portfolio and maturation of the loan 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 determining the allowance for loan losses, we estimate probable losses separately for segments of the loan portfolio that have similar risk characteristics. We use a migration analysis to estimate the likelihood that a loan will progress through the various stages of delinquency. We use other analyses to estimate losses incurred from non-delinquent accounts, which adds to the identification of loss emergence. We use these analyses together as a basis for determining our allowance for loan losses.

The provision for loan losses is the amount of expense realized after considering the level of net charge-offs in the period and the required amount of allowance for loan losses at the balance sheet date. For the year ended December 31, 2019, the provision for loan losses increased by \$196 million, or 6%, as compared to the year ended December 31, 2018 primarily due to higher levels of net charge-offs, slightly offset by lower reserve builds.

The allowance for loan losses was \$3.4 billion at December 31, 2019, which reflects a \$342 million reserve build over the amount of the allowance for loan losses at December 31, 2018. The reserve build, which primarily related to credit card loans, was because of seasoning of continued loan growth and to a lesser extent supply-driven credit normalization.

The following tables provide changes in our allowance for loan losses (dollars in millions):

	For the Year Ended December 31, 2019				
	Credit Card	Personal Loans	Student Loans ⁽¹⁾	Other	Total
Balance at beginning of period	\$ 2,528	\$ 338	\$ 169	\$ 6	\$ 3,041
Additions					
Provision for loan losses	2,849	332	51	(1)	3,231
Deductions					
Charge-offs	(3,165)	(369)	(82)	(1)	(3,617)
Recoveries	671	47	13	—	731
Net charge-offs	(2,494)	(322)	(69)	(1)	(2,886)
Other ⁽²⁾	—	—	(3)	—	(3)
Balance at end of period	<u>\$ 2,883</u>	<u>\$ 348</u>	<u>\$ 148</u>	<u>\$ 4</u>	<u>\$ 3,383</u>

	For the Year Ended December 31, 2018				
	Credit Card	Personal Loans	Student Loans ⁽¹⁾	Other	Total
Balance at beginning of period	\$ 2,147	\$ 301	\$ 162	\$ 11	\$ 2,621
Additions					
Provision for loan losses	2,594	345	95	1	3,035
Deductions					
Charge-offs	(2,734)	(345)	(97)	(6)	(3,182)
Recoveries	521	37	12	—	570
Net charge-offs	(2,213)	(308)	(85)	(6)	(2,612)
Other ⁽²⁾	—	—	(3)	—	(3)
Balance at end of period	<u>\$ 2,528</u>	<u>\$ 338</u>	<u>\$ 169</u>	<u>\$ 6</u>	<u>\$ 3,041</u>

	For the Year Ended December 31, 2017				
	Credit Card	Personal Loans	Student Loans ⁽¹⁾	Other	Total
Balance at beginning of period	\$ 1,790	\$ 200	\$ 158	\$ 19	\$ 2,167
Additions					
Provision for loan losses	2,159	332	93	(5)	2,579
Deductions					
Charge-offs	(2,263)	(258)	(94)	(3)	(2,618)
Recoveries	461	27	11	—	499
Net charge-offs	(1,802)	(231)	(83)	(3)	(2,119)
Other ⁽²⁾	—	—	(6)	—	(6)
Balance at end of period	<u>\$ 2,147</u>	<u>\$ 301</u>	<u>\$ 162</u>	<u>\$ 11</u>	<u>\$ 2,621</u>

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

(2) Net change in reserves on PCI pools having no remaining non-accretable difference.

The following tables provide changes in our allowance for loan losses (dollars in millions):

	For the Year Ended December 31, 2016				
	Credit Card	Personal Loans	Student Loans ⁽¹⁾	Other	Total
Balance at beginning of period	\$ 1,554	\$ 155	\$ 143	\$ 17	\$ 1,869
Additions					
Provision for loan losses	1,579	196	82	2	1,859
Deductions					
Charge-offs	(1,786)	(172)	(76)	—	(2,034)
Recoveries	443	21	9	—	473
Net charge-offs	(1,343)	(151)	(67)	—	(1,561)
Balance at end of period	\$ 1,790	\$ 200	\$ 158	\$ 19	\$ 2,167

	For the Year Ended December 31, 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	1,300	147	64	1	1,512
Deductions					
Charge-offs	(1,660)	(129)	(65)	(1)	(1,855)
Recoveries	440	17	9	—	466
Net charge-offs	(1,220)	(112)	(56)	(1)	(1,389)
Balance at end of period	\$ 1,554	\$ 155	\$ 143	\$ 17	\$ 1,869

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

Net Charge-offs

Our net charge-offs include the principal amount of losses charged off less principal recoveries and exclude charged-off and recovered interest and fees and fraud losses. Charged-off and recovered interest and fees are recorded in interest income and loan fee income, respectively, which is effectively a reclassification of the provision for loan losses, while fraud losses are recorded in other expense.

The following table presents amounts and rates of net charge-offs of key loan products (dollars in millions):

	For the Years Ended December 31,									
	2019		2018		2017		2016		2015	
	\$	%	\$	%	\$	%	\$	%	\$	%
Credit card loans	\$ 2,494	3.43%	\$ 2,213	3.26%	\$ 1,802	2.91%	\$ 1,343	2.34%	\$ 1,220	2.22%
Personal loans	\$ 322	4.28%	\$ 308	4.15%	\$ 231	3.30%	\$ 151	2.55%	\$ 112	2.15%
Private student loans (excluding PCI ⁽¹⁾)	\$ 69	0.85%	\$ 85	1.14%	\$ 83	1.21%	\$ 67	1.10%	\$ 56	1.07%

(1) See Note 4: Loan Receivables to our consolidated financial statements for information regarding the accounting for charge-offs on PCI loans.

The net charge-off rates on our credit card and personal loans increased for the year ended December 31, 2019 as compared to the year ended December 31, 2018 as a result of seasoning of continued loan growth and supply-driven credit normalization. Net charge-offs on our private student loans decreased for the year ended December 31, 2019 as compared to the year ended December 31, 2018 due to more effective collection strategies.

Delinquencies

Delinquencies are an indicator of credit quality at a point in time. A loan balance is considered delinquent when contractual payments on the loan become 30 days past due.

The following table presents the amounts and delinquency rates of key loan products that are 30 and 90 days or more delinquent, loan receivables that are not accruing interest regardless of delinquency, and restructured loans (dollars in millions):

	Years Ended December 31,									
	2019		2018		2017		2016		2015	
	\$	%	\$	%	\$	%	\$	%	\$	%
Loans 30 or more days delinquent										
Credit card loans	\$ 2,019	2.62%	\$ 1,772	2.43%	\$ 1,532	2.28%	\$ 1,252	2.04%	\$ 995	1.72%
Personal loans	\$ 105	1.37%	\$ 119	1.60%	\$ 103	1.40%	\$ 74	1.12%	\$ 49	0.89%
Private student loans (excluding PCI loans ⁽¹⁾)	\$ 145	1.72%	\$ 155	2.00%	\$ 167	2.35%	\$ 141	2.22%	\$ 108	1.91%
Loans 90 or more days delinquent										
Credit card loans ⁽²⁾	\$ 1,020	1.32%	\$ 887	1.22%	\$ 751	1.12%	\$ 597	0.97%	\$ 490	0.85%
Personal loans ⁽³⁾	\$ 31	0.40%	\$ 35	0.47%	\$ 30	0.41%	\$ 19	0.29%	\$ 15	0.27%
Private student loans (excluding PCI loans ⁽¹⁾) ⁽⁴⁾	\$ 36	0.42%	\$ 38	0.49%	\$ 33	0.47%	\$ 35	0.55%	\$ 24	0.43%
Loans not accruing interest	\$ 266	0.28%	\$ 302	0.34%	\$ 233	0.28%	\$ 216	0.29%	\$ 224	0.32%
Restructured loans										
Credit card loans										
Currently enrolled	\$ 2,108	2.73%	\$ 1,649	2.26%	\$ 926	1.38%	\$ 781	1.27%	\$ 746	1.29%
No longer enrolled	1,254	1.62	599	0.82	390	0.58	304	0.49	273	0.47
Total credit card loans ⁽²⁾	\$ 3,362	4.35%	\$ 2,248	3.08%	\$ 1,316	1.96%	\$ 1,085	1.76%	\$ 1,019	1.76%
Personal loans ⁽³⁾	\$ 208	2.71%	\$ 152	2.04%	\$ 111	1.51%	\$ 81	1.25%	\$ 68	1.24%
Private student loans (excluding PCI loans ⁽¹⁾) ⁽⁴⁾	\$ 269	3.20%	\$ 182	2.36%	\$ 137	1.94%	\$ 86	1.35%	\$ 48	0.85%

(1) Excludes PCI loans, which are accounted for on a pooled basis. Since a pool is accounted for as a single asset with a single composite interest rate and aggregate expectation of cash flows, the past-due status of a pool, or that of the individual loans within a pool, is not meaningful. Because we are recognizing interest income on a pool of loans, it is all considered to be performing.

(2) Restructured credit card loans include \$184 million, \$124 million, \$74 million, \$60 million and \$44 million at December 31, 2019, 2018, 2017, 2016 and 2015, respectively, which are also included in loans 90 or more days delinquent.

(3) Restructured personal loans include \$7 million, \$6 million, \$5 million, \$2 million and \$4 million at December 31, 2019, 2018, 2017, 2016 and 2015, respectively, which are also included in loans 90 or more days delinquent.

(4) Restructured private student loans include \$10 million, \$7 million, \$5 million, \$3 million and \$3 million at December 31, 2019, 2018, 2017, 2016 and 2015, respectively, which are also included in loans 90 or more days delinquent.

The 30-day and 90-day delinquency rates for credit card loans at December 31, 2019 increased as compared to December 31, 2018 primarily due to seasoning of continued loan growth and supply-driven credit normalization. The 30-day and 90-day delinquency rates for personal loans decreased at December 31, 2019 compared to December 31, 2018 as a result of improved underwriting and more effective collection strategies. The 30-day and 90-day delinquency rates for student loans decreased at December 31, 2019 compared to December 31, 2018 due to more effective collection strategies.

The restructured credit card, personal and private student loan balances increased at December 31, 2019 as compared to December 31, 2018 due to seasoning of continued loan growth and improved awareness of programs available to assist borrowers having difficulties meeting payment obligations. To provide additional clarity with respect to credit card loans classified as troubled debt restructurings, the table above now discloses the balance of those loans currently enrolled or no longer enrolled in a loan modification program. We believe loan modification programs are useful in assisting customers experiencing financial difficulties and help to prevent defaults. Of the \$1,254 million of credit card loans that had been modified and are classified as troubled debt restructurings but for which the borrowers

are no longer enrolled in a loan modification program at December 31, 2019, \$1,038 million represents balances associated with borrowers that successfully completed the program. We plan to continue to use loan modification programs as a means to provide relief to customers experiencing temporary financial difficulties. See Note 4: Loan Receivables to our consolidated financial statements for further description of our use of loan modifications to provide relief to customers experiencing financial hardship.

Modified and Restructured Loans

For information regarding modified and restructured loans, see “— Delinquencies” and Note 4: Loan Receivables to our consolidated financial statements.

Maturities and Sensitivities of Loan Receivables to Changes in Interest Rates

Our loan portfolio had the following maturity distribution⁽¹⁾ (dollars in millions):

At December 31, 2019	Due One Year or Less	Due After One Year Through Five Years	Due After Five Years	Total
Credit card loans	\$ 23,147	\$ 41,052	\$ 12,982	\$ 77,181
Personal loans	2,157	5,236	294	7,687
Private student loans (excluding PCI)	209	1,885	6,308	8,402
PCI loans	141	418	692	1,251
Other loans	50	247	1,076	1,373
Total loan portfolio	<u>\$ 25,704</u>	<u>\$ 48,838</u>	<u>\$ 21,352</u>	<u>\$ 95,894</u>

(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 December 31, 2019, approximately \$42.4 billion of our loan portfolio due after one year had interest rates tied to an index and approximately \$27.8 billion were fixed-rate loans.

Other Income

The following table presents the components of other income (dollars in millions):

	For the Years Ended December 31,			2019 vs. 2018 (Decrease) Increase		2018 vs. 2017 Increase (Decrease)	
	2019	2018	2017	\$	%	\$	%
Discount and interchange revenue, net ⁽¹⁾	\$ 1,066	\$ 1,074	\$ 1,052	\$ (8)	(1)%	\$ 22	2 %
Protection products revenue	194	204	223	(10)	(5)%	(19)	(9)%
Loan fee income	449	402	363	47	12 %	39	11 %
Transaction processing revenue	197	178	167	19	11 %	11	7 %
Other income	90	97	92	(7)	(7)%	5	5 %
Total other income	<u>\$ 1,996</u>	<u>\$ 1,955</u>	<u>\$ 1,897</u>	<u>\$ 41</u>	<u>2 %</u>	<u>\$ 58</u>	<u>3 %</u>

(1) Net of rewards, including Cashback Bonus rewards, of \$1.9 billion, \$1.8 billion and \$1.6 billion for the years ended December 31, 2019, 2018 and 2017, respectively.

Total other income increased \$41 million for the year ended December 31, 2019 as compared to the year ended December 31, 2018, which was primarily driven by higher loan fee income and transaction processing revenue. Loan fee income was higher as a result of an increase in late fees. The increase in transaction processing revenue was due to greater transaction volume on the PULSE network. Net discount and interchange revenue was relatively flat for the year ended December 31, 2019 as compared to the year ended December 31, 2018 with offsetting increases in gross discount and interchange revenue and rewards, both of which were primarily the result of higher sales volume.

Other Expense

The following table represents the components of other expense (dollars in millions):

	For the Years Ended December 31,			2019 vs. 2018 Increase		2018 vs. 2017 Increase	
	2019	2018	2017	\$	%	\$	%
Employee compensation and benefits	\$ 1,738	\$ 1,627	\$ 1,512	\$ 111	7%	\$ 115	8%
Marketing and business development	883	857	776	26	3%	81	10%
Information processing and communications	409	350	315	59	17%	35	11%
Professional fees	753	672	655	81	12%	17	3%
Premises and equipment	107	102	99	5	5%	3	3%
Other expense	503	469	424	34	7%	45	11%
Total other expense	\$ 4,393	\$ 4,077	\$ 3,781	\$ 316	8%	\$ 296	8%

Total other expense increased \$316 million for the year ended December 31, 2019 as compared to the year ended December 31, 2018. The increase was primarily driven by higher employee compensation and benefits, professional fees, and information processing and communications. Employee compensation and benefits increased as a result of higher average salaries. The increase in professional fees was primarily driven by higher collection fees resulting from increased recoveries, as well as investments in technological capabilities. Information processing and communications was higher due to continued investment in infrastructure and analytic capabilities.

Income Tax Expense

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

	For the Years Ended December 31,		
	2019	2018	2017
U.S. federal statutory income tax rate	21.0 %	21.0 %	35.0 %
U.S. state, local and other income taxes, net of U.S. federal income tax benefits	3.5	3.6	3.1
Revaluation of net deferred tax assets and other investments due to tax reform ⁽¹⁾	—	—	5.1
Tax credits	(1.4)	(1.3)	(1.3)
Other	(0.2)	0.5	(1.2)
Effective income tax rate	22.9 %	23.8 %	40.7 %
Income tax expense	\$ 878	\$ 855	\$ 1,438

(1) See Note 3: Investments — Other Investments to our consolidated financial statements for a description of these investments.

For the year ended December 31, 2019, income tax expense increased \$23 million, or 2.7%, and the effective income tax rate decreased 0.9 percentage points as compared to the year ended December 31, 2018. The increase in income tax expense was primarily driven by increased pretax income. The effective tax rate decreased primarily due to the resolution of certain tax matters.

Liquidity and Capital Resources

Funding and Liquidity

We seek to maintain stable, diversified and cost-effective funding sources and a strong liquidity profile in order to fund our business and repay or refinance our maturing obligations under both normal operating conditions and periods of economic or financial stress. In managing our liquidity risk, we seek to maintain a prudent liability maturity profile and ready access to an ample store of primary and contingent liquidity sources. Our primary funding sources include direct-to-consumer and brokered deposits, public term asset-backed securitizations and other short-term and long-term borrowings. Our primary liquidity sources include a liquidity portfolio comprised of highly liquid, unencumbered assets, including cash and cash equivalents and investment securities, and borrowing capacity through

private term asset-backed securitizations. In addition, we have unused borrowing capacity with the Federal Reserve discount window, which provides another source of contingent liquidity.

Funding Sources

Deposits

We offer 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 online savings accounts, certificates of deposit, money market accounts, IRA certificates of deposit and checking accounts, while brokered deposits include certificates of deposit and sweep accounts. At December 31, 2019, we had \$54.4 billion of direct-to-consumer deposits and \$18.3 billion of brokered and other deposits.

Credit Card Securitization Financing

We securitize credit card receivables as a source of funding. We access the asset-backed securitization market using the Discover Card Master Trust I (“DCMT”) and the Discover Card Execution Note Trust (“DCENT”), through which we issue DCENT DiscoverSeries notes in both public and private transactions. From time to time, we may add credit card receivables to these trusts to create sufficient funding capacity for future securitizations while managing seller’s interest. We retain significant exposure to the performance of trust assets through holdings of the seller’s interest and subordinated security classes of DCENT.

The securitization structures include certain features designed to protect investors. 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, 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 fell below 0% on a three-month rolling average basis, we would be required to repay the affected outstanding securitized borrowings using available collections received by the trust; the period of ultimate repayment would be determined by the amount and timing of collections received. An early amortization event would impair our liquidity, and may require us to utilize our available non-securitization related contingent liquidity or rely on alternative funding sources, which may or may not be available at the time. As of December 31, 2019, the DiscoverSeries three-month rolling average excess spread was 13.44%.

We may elect to add receivables to the restricted pool of receivables, subject to certain requirements. Through our wholly-owned indirect subsidiary, Discover Funding LLC, we are 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. 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 interests held by us). If the level of receivables in the trust were to fall below the required minimum, we 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 we could not add enough receivables to satisfy the minimum seller’s interest requirement, an early amortization (or repayment) of investors’ interests would be triggered. No accounts were added to those restricted for securitization investors for the year ended December 31, 2019.

At December 31, 2019, we had \$14.1 billion of outstanding public asset-backed securities and \$4.8 billion of outstanding subordinated asset-backed securities that had been issued to our wholly-owned subsidiaries.

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The following table summarizes expected contractual maturities of the investors' interests in credit card securitizations, excluding those that have been issued to our wholly-owned subsidiaries (dollars in millions):

At December 31, 2019	Total	Less Than One Year	One Year Through Three Years	Four Years Through Five Years	After Five Years
Scheduled maturities of long-term borrowings - owed to credit card securitization investors	\$ 14,124	\$ 3,498	\$ 7,841	\$ 2,785	\$ —

The triple-A rating of DCENT Class A Notes issued to date has been based, in part, on an FDIC rule, which created a safe harbor that provides that the FDIC, as conservator or receiver, will not, using its power to disaffirm or repudiate contracts, 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 satisfies the conditions for sale accounting treatment under previous GAAP. Although the implementation of the Financial Accounting Standards Board Accounting Standards Codification Topic 860, *Transfers and Servicing*, no longer qualified certain transfers of assets for sale accounting treatment, the FDIC approved a final rule that preserved the safe-harbor treatment applicable to revolving trusts and master trusts, including DCMT, so long as those trusts would have satisfied the original FDIC safe harbor if evaluated under GAAP pertaining to transfers of financial assets in effect prior to December 2009. Other legislative and regulatory developments may, however, impact our ability and/or desire to issue asset-backed securities in the future.

Other Long-Term Borrowings—Student Loans

At December 31, 2019, \$161 million of remaining principal balance was outstanding on securitized debt assumed as part of our acquisition of The Student Loan Corporation. Principal and interest payments on the underlying student loans will reduce the balance of these secured borrowings over time.

Other Long-Term Borrowings—Corporate and Bank Debt

The following table provides a summary of Discover Financial Services (Parent Company) and Discover Bank outstanding fixed-rate debt (dollars in millions):

At December 31, 2019	Principal Amount Outstanding
Discover Financial Services (Parent Company) fixed-rate senior notes, maturing 2022-2027	\$ 3,422
Discover Financial Services (Parent Company) fixed-rate retail notes, maturing 2021-2031	\$ 344
Discover Bank fixed-rate senior bank notes, maturing 2020-2028	\$ 6,850
Discover Bank fixed-rate subordinated bank notes, maturing 2020-2028	\$ 1,000

Certain Discover Financial Services senior notes require us to offer to repurchase the notes at a price equal to 101% of their aggregate principal amount plus accrued and unpaid interest in the event of a change of control involving us and a corresponding ratings downgrade to below investment grade.

Short-Term Borrowings

As part of our regular funding strategy, we may from time to time borrow short-term funds in the federal funds market or the repurchase ("repo") market through repurchase agreements. Federal funds are short-term, unsecured loans between banks or other financial entities with a Federal Reserve account. Funds borrowed in the repo market are short-term, collateralized loans, usually secured with highly-rated investment securities such as U.S. Treasury bills or notes, or federal agency mortgage bonds or debentures. At December 31, 2019, there were no outstanding balances in the federal funds market or repurchase agreements.

Additional Funding Sources

Private Asset-Backed Securitizations

We have access to committed borrowing capacity through privately placed asset-backed securitizations. At December 31, 2019, we had total committed capacity of \$6.0 billion, \$500 million of which was drawn. While we

may utilize funding from these private securitizations from time to time for normal business operations, their committed nature also makes them a reliable contingency funding source. Therefore, we reserve some undrawn capacity, informed by our liquidity stress test results, for potential contingency funding needs. We also seek to ensure the stability and reliability of these securitizations by staggering their maturity dates, renewing them approximately one year prior to their scheduled maturity dates and periodically drawing them for operational testing purposes and seasonal funding needs.

Federal Reserve

Discover Bank has access to the Federal Reserve Bank of Philadelphia's discount window. As of December 31, 2019, Discover Bank had \$34.2 billion of available borrowing capacity through the discount window based on the amount and type of assets pledged, primarily consumer loans. We have no borrowings outstanding under the discount window and reserve this capacity as a source of contingent liquidity.

Funding Uses

Our primary uses of funds include the extensions of loans and credit, primarily through Discover Bank, the purchase of investment securities for our liquidity portfolio, working capital, and debt and capital service. We assess funding uses and liquidity needs under stressed and normal operating conditions, considering primary uses of funding, such as on-balance sheet loans, and contingent uses of funding, such as the need to post additional collateral for derivatives positions. In order to anticipate funding needs under stress, we conduct liquidity stress tests to assess the impact of idiosyncratic, systemic and hybrid (idiosyncratic and systemic) scenarios with varying levels of liquidity risk reflecting a range of stress severity.

Credit Ratings

Our borrowing costs and capacity in certain funding markets, including those for securitizations and unsecured senior and subordinated debt, may be affected by the credit ratings of DFS, Discover Bank and the securitization trusts. Downgrades in these credit ratings could result in higher interest expense on our unsecured debt and asset securitizations, as well as higher collateral enhancement requirements for both our public and private asset securitizations. In addition to increased funding costs, deterioration in credit ratings could reduce our borrowing capacity in the unsecured debt and asset securitization capital markets.

We also maintain agreements with certain of our derivative counterparties that contain provisions that require DFS and Discover Bank to maintain an investment grade credit rating from specified major credit rating agencies. At December 31, 2019, Discover Bank's credit rating met specified thresholds set by its counterparties. However, if its credit ratings were to fall below investment grade, Discover Bank would be required to post additional collateral, which, as of December 31, 2019, would have been \$20 million. DFS (Parent Company) had no outstanding derivatives as of December 31, 2019, and therefore, no collateral was required.

The table below reflects our current credit ratings and outlooks:

	Moody's Investors Service	Standard & Poor's	Fitch Ratings
Discover Financial Services			
Senior unsecured debt	Baa3	BBB-	BBB+
Outlook for Discover Financial Services senior unsecured debt	Stable	Stable	Stable
Discover Bank			
Senior unsecured debt	Baa2	BBB	BBB+
Outlook for Discover Bank senior unsecured debt	Stable	Stable	Stable
Subordinated debt	Baa3	BBB-	BBB
Discover Card Execution Note Trust			
Class A(1)	Aaa(sf)	AAA(sf)	AAA(sf)

(1) An "sf" in the rating denotes rating agency identification for structured finance product ratings.

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.

Liquidity

We seek to ensure that we have adequate liquidity to sustain business operations, fund asset growth and satisfy debt obligations under stressed and normal operating conditions. In addition to the funding sources discussed in the previous section, we also maintain highly liquid, unencumbered assets in our liquidity portfolio that we expect to be able to convert to cash quickly and with little loss of value using either the repo market or outright sales.

We maintain a liquidity risk and funding management policy, which outlines the overall framework and general principles we follow in managing liquidity risk across our business. The policy is approved by the Board of Directors with implementation responsibilities delegated to the Asset and Liability Management Committee (the "ALCO"). Additionally, we maintain a liquidity management framework document, which outlines the general strategies, objectives and principles we utilize to manage our liquidity position and the various liquidity risks inherent in our business model. We seek to balance the trade-offs between maintaining too much liquidity, which may be costly, with having too little liquidity, which could cause financial distress. Liquidity risk is centrally managed by the ALCO, which is chaired by our Treasurer and has cross-functional membership. The ALCO monitors the liquidity risk profiles of DFS and Discover Bank and oversees any actions Corporate Treasury may take to ensure that we maintain ready access to our funding sources and sufficient liquidity to meet current and projected needs. In addition, the ALCO and our Board of Directors regularly review our compliance with our liquidity limits at DFS and Discover Bank, which are established in accordance with the liquidity risk appetite set by our Board of Directors.

We employ a variety of metrics to monitor and manage liquidity. We utilize early warning indicators ("EWIs") to detect the initial phases of liquidity stress events and a reporting and escalation process that is designed to be consistent with regulatory guidance. The EWIs include both idiosyncratic and systemic measures, and are monitored on a daily basis and reported to the ALCO regularly. A warning from one or more of these indicators triggers prompt review and decision-making by our senior management team, and in certain instances may lead to the convening of a senior-level response team and activation of our contingency funding plan.

In addition, we conduct liquidity stress tests regularly and ensure contingency funding is in place to address potential liquidity shortfalls. We evaluate a range of stress scenarios that are designed in accordance with regulatory requirements, including idiosyncratic, systemic and a combination of such events that could impact funding sources and our ability to meet liquidity needs. These scenarios measure the projected liquidity position at DFS and Discover Bank across a range of time horizons by comparing estimated contingency funding needs to available contingent liquidity.

Our primary contingent liquidity sources include our liquidity portfolio and private securitizations with unused borrowing capacity. In addition, we have unused borrowing capacity with the Federal Reserve discount window, which provides an additional source of contingent liquidity. We seek to maintain sufficient liquidity to be able to satisfy all maturing obligations and fund business operations for at least 12 months in a severe stress environment. In such an environment, we may also take actions to curtail the size of our balance sheet, which would reduce the need for funding and liquidity.

At December 31, 2019, our liquidity portfolio is comprised of highly liquid, unencumbered assets, including cash and cash equivalents and investment securities. Cash and cash equivalents were primarily in the form of deposits with the Federal Reserve. Investment securities primarily included debt obligations of the U.S. Treasury and residential mortgage-backed securities issued by U.S. government housing agencies or government-sponsored enterprises. These investments are considered highly liquid, and we expect to have the ability to raise cash by selling them, utilizing repurchase agreements or pledging certain of these investments to access secured funding. The size and composition of our liquidity portfolio may fluctuate based upon the size of our balance sheet as well as operational requirements, market conditions and interest rate risk management policies. For example, we have altered the composition of our liquidity portfolio to mitigate the potential volatility of earnings that may arise from changes in interest rates.

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At December 31, 2019, our liquidity portfolio and undrawn credit facilities were \$56.3 billion, which was \$3.4 billion higher than the balance at December 31, 2018. During the year ended December 31, 2019, the average balance of our liquidity portfolio was \$18.1 billion.

	December 31,	
	2019	2018
	(dollars in millions)	
Liquidity portfolio		
Cash and cash equivalents ⁽¹⁾	\$ 6,406	\$ 12,832
Investment securities ⁽²⁾	10,202	3,091
Total liquidity portfolio	16,608	15,923
Private asset-backed securitizations ⁽³⁾	5,500	5,500
Primary liquidity sources	22,108	21,423
Federal Reserve discount window ⁽³⁾	34,220	31,486
Total liquidity portfolio and undrawn credit facilities	<u>\$ 56,328</u>	<u>\$ 52,909</u>

(1) Cash in the process of settlement and restricted cash are excluded from cash and cash equivalents for liquidity purposes.

(2) Excludes \$121 million and \$42 million of U.S. Treasury securities that have been pledged as swap collateral in lieu of cash as of December 31, 2019 and 2018, respectively.

(3) See "— Additional Funding Sources" for additional information.

Bank Holding Company Liquidity

The primary uses of funds at the unconsolidated DFS level include debt service obligations (interest payments and return of principal) and capital service and management activities, which include dividend payments on capital instruments and the periodic repurchase of shares of our common stock. Our primary sources of funds at the bank holding company level include the proceeds from the issuance of unsecured debt and capital securities, as well as dividends from our subsidiaries, particularly Discover Bank. Under periods of idiosyncratic or systemic stress, the bank holding company could lose or experience impaired access to the capital markets. In addition, our regulators have the discretion to restrict dividend payments from Discover Bank to the bank holding company.

We utilize a measure referred to as Number of Months of Pre-Funding to determine the length of time Discover Financial Services can meet upcoming funding obligations including common and preferred stock dividend payments and debt service obligations using existing cash resources.

We structure our debt maturity schedule to minimize the amount of debt maturing within a short period of time. See Note 9: Long-Term Borrowings to our consolidated financial statements for further information regarding our debt.

Capital

Our primary sources of capital are the earnings generated by our businesses and the proceeds from issuances of capital securities. We seek to manage capital to a level and composition sufficient to support the growth and risks of our businesses and to meet regulatory requirements, rating agency targets and debt investor expectations. Within these constraints, we are focused on deploying capital in a manner that provides attractive returns to our stockholders. The level, composition and utilization of capital are influenced by changes in the economic environment, strategic initiatives, and legislative and regulatory developments.

Under regulatory capital requirements adopted by the Federal Reserve and the FDIC, DFS, along with Discover Bank, must maintain minimum levels of capital. Failure to meet minimum capital requirements can result in the initiation of certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could limit our business activities and have a direct material effect on our financial position and results. We must meet specific capital requirements that involve quantitative measures of assets, liabilities and certain off-balance sheet items, as calculated under regulatory guidance and regulations. Current or future legislative or regulatory reforms, such as the future implementation of CECL, may require us to hold more capital or adversely impact our capital level. We consider the potential impacts of these reforms in managing our capital position.

Discover Financial Services and Discover Bank are subject to regulatory capital requirements that became effective January 2015 under final rules issued by the Federal Reserve and the Federal Deposit Insurance Corporation

to implement the provisions under the Basel Committee's December 2010 framework ("Basel III rules"). The Basel III rules require Discover Financial Services and Discover Bank to maintain minimum risk-based capital and leverage ratios and define what constitutes capital for purposes of calculating those ratios. Under Basel III rules for regulatory capital, DFS and Discover Bank are classified as "Standardized Approach" entities, defined as U.S. banking organizations with consolidated total assets over \$50 billion but not exceeding \$250 billion and consolidated total on-balance sheet foreign exposures less than \$10 billion. As of January 1, 2019, thresholds within the Basel III rules are fully phased in with the exception of certain transition provisions that were frozen pursuant to regulation issued in November 2017. Pursuant to a final rule issued in July 2019, the transition provisions that were previously frozen will be replaced with new permanent thresholds as discussed below. For additional information regarding the risk-based capital and leverage ratios, see Note 17: Capital Adequacy to our consolidated financial statements.

The Basel III rules also introduced a capital conservation buffer ("CCB") on top of the minimum risk-weighted asset ratios. The buffer is designed to absorb losses during periods of economic stress. The application of the buffer was subject to phase-in periods that ended December 31, 2019. Then beginning January 1, 2019, the CCB effectively results in minimum regulatory capital ratios (including the CCB) of (i) Common Equity Tier 1 ("CET1") to risk-weighted assets of at least 7.0%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5% and (iii) Total capital to risk-weighted assets of at least 10.5%. Banking institutions with a capital ratio below the required threshold will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. There is a proposal under regulatory review by the Federal Reserve that would effectively replace the CCB with a new buffer requirement for DFS that is linked to supervisory stress testing results (i.e., the Stress Capital Buffer), see "— Regulatory Environment and Developments."

The Basel III rules provide for certain threshold-based deductions from and adjustments to CET1, to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15%. In July 2019, federal banking regulators issued a final rule that, among other things, revises certain capital requirements for Standardized Approach banks by raising the 10% of CET1 deduction threshold for certain items to 25% and eliminates the 15% combined deduction threshold applying to these items. These changes will become effective for all Standardized Approach banking institutions in April 2020, although banks have the option to adopt early beginning on January 1, 2020.

Basel III rules also require disclosures relating to market discipline. This series of disclosures is commonly referred to as "Pillar 3." The objective is to increase transparency of capital requirements for banking organizations. We are required to make prescribed regulatory disclosures on a quarterly basis regarding our capital structure, capital adequacy, risk exposures and risk-weighted assets. The Pillar 3 disclosures are made publicly available on our website in a report called "Basel III Regulatory Capital Disclosures."

At December 31, 2019, DFS and Discover Bank met the requirements for "well-capitalized" status under Regulation Y and the prompt corrective action rules, respectively, exceeding the regulatory minimums to which they were subject under the applicable rules.

We disclose tangible common equity, which represents common equity less goodwill and intangibles. Management believes that common stockholders' equity excluding goodwill and intangibles is a meaningful measure to investors of our true net asset value. As of December 31, 2019, tangible common equity is not formally defined by U.S. GAAP or codified in the federal banking regulations and, as such, is considered to be a non-GAAP financial measure. Other financial services companies may also disclose this measure and definitions may vary, so we advise users of this information to exercise caution in comparing this measure for different companies.

The following table provides a reconciliation of total common stockholders' equity (a U.S. GAAP financial measure) to tangible common equity (dollars in millions):

	December 31,	
	2019	2018
Total common stockholders' equity ⁽¹⁾	\$ 11,296	\$ 10,567
Less: goodwill	(255)	(255)
Less: intangible assets, net	(155)	(161)
Tangible common equity	<u>\$ 10,886</u>	<u>\$ 10,151</u>

(1) Total common stockholders' equity is calculated as total stockholders' equity less preferred stock.

Additionally, we are subject to regulatory requirements imposed by the Federal Reserve as part of its stress testing framework and CCAR program. Refer to “— Regulatory Environment and Developments” for more information.

For the period between July 1, 2019 and June 30, 2020, the Federal Reserve pre-approved capital distributions up to a maximum amount for each Category IV bank, including Discover. The Federal Reserve based these capital distribution limits on results from the 2018 supervisory stress test. Notwithstanding the pre-approval, we were still required to prepare a capital plan to be approved by our Board of Directors. This plan outlined our contemplated capital distributions for the period from July 1, 2019 to June 30, 2020, which were within the Federal Reserve’s pre-approved amount.

After our Board of Directors approved our capital plan, we submitted our planned capital actions to the Federal Reserve in April 2019. Pursuant to that plan, we are returning capital to our shareholders by paying dividends on our common and preferred stock and repurchasing shares of our common stock. We recently declared a quarterly cash dividend on our common stock of \$0.44 per share, payable on March 5, 2020 to holders of record on February 20, 2020, which is consistent with the amount paid in the third and fourth quarters of 2019. We also recently declared a semi-annual cash dividend on our preferred stock of \$2,750 per share, equal to \$27.50 per depository share, payable on April 30, 2020 to holders of record on April 15, 2020, which is consistent with the amount paid in the second and fourth quarters of 2019. On July 18, 2019, our Board of Directors approved a share repurchase program authorizing the repurchase of up to \$2.2 billion of our outstanding shares of common stock. The program expires on September 30, 2020 and may be terminated at any time. This program replaced the prior \$3.0 billion share repurchase program, which had \$1.2 billion of remaining authorization. During the year ended December 31, 2019, we repurchased approximately 22 million shares, or 7%, of our outstanding common stock for \$1.7 billion. We expect to continue to repurchase shares under our program from time to time based on market conditions and other factors, subject to legal and regulatory requirements and restrictions, including limitations from the Federal Reserve as described above. Share repurchases under the program may be made through a variety of methods, including open market purchases, privately negotiated transactions or other purchases, including block trades, accelerated share repurchase transactions, or any combination of such methods.

The amount and size of any future dividends and share repurchases will depend upon our results of operations, financial condition, capital levels, cash requirements, future prospects and other factors, such as the implementation of CECL. The declaration and payment of future dividends, as well as the amount thereof, are subject to the discretion of our Board of Directors. Holders of our shares of common stock are subject to the prior dividend rights of holders of our preferred stock or the depository shares representing such preferred stock outstanding, and if full dividends have not been declared and paid on all outstanding shares of preferred stock in any dividend period, no dividend may be declared or paid or set aside for payment on our common stock. In addition, as noted above, banking laws and regulations and our banking regulators may limit our ability to pay dividends and make share repurchases, including limitations on the extent to which our banking subsidiaries can provide funds to us through dividends, loans or otherwise. Further, current or future regulatory reforms may require us to hold more capital or adversely impact our capital level. There can be no assurance that we will declare and pay any dividends or repurchase any shares of our common stock in the future. For more information, including conditions and limits on our ability to pay dividends and repurchase our stock, see “Business — Supervision and Regulation — Capital, Dividends and Share Repurchases,” “Risk Factors — Credit, Market and Liquidity Risk — *We may be limited in our ability to pay dividends on and repurchase our stock*” and “— *We are a holding company and depend on payments from our subsidiaries*” and Note 17: Capital Adequacy to our consolidated financial statements.

Certain Off-Balance Sheet Arrangements

Guarantees

Guarantees are contracts or indemnification agreements that contingently require us to make payments to a guaranteed party based on changes in an underlying asset, liability, or equity security of a guaranteed party, rate or index. Also included in guarantees are contracts that contingently require the guarantor to make payments to a guaranteed party based on another entity’s failure to perform under an agreement. Our guarantees relate to transactions processed on the Discover Network and certain transactions processed by PULSE and Diners Club. See Note 18: Commitments, Contingencies and Guarantees to our consolidated financial statements for further discussion regarding our guarantees.

Contractual Obligations and Contingent Liabilities and Commitments

In the normal course of business, we enter into various contractual obligations that may require future cash payments. Contractual obligations include deposits, long-term borrowings, operating lease obligations, interest payments on fixed-rate debt, purchase obligations and other liabilities. Our future cash payments associated with our contractual obligations are summarized below (dollars in millions):

At December 31, 2019	Total	Payments Due By Period			
		Less Than One Year	One Year Through Three Years	Four Years Through Five Years	More Than Five Years
Deposits ⁽¹⁾⁽²⁾	\$ 72,746	\$ 57,341	\$ 10,272	\$ 3,222	\$ 1,911
Borrowings ⁽³⁾	25,701	5,247	9,329	5,884	5,241
Operating leases	128	14	27	28	59
Interest payments on fixed-rate debt	2,648	614	922	576	536
Purchase obligations ⁽⁴⁾	1,237	641	369	180	47
Other liabilities ⁽⁵⁾	301	53	72	42	134
Total contractual obligations	\$ 102,761	\$ 63,910	\$ 20,991	\$ 9,932	\$ 7,928

- (1) Deposits do not include interest payments because payment amounts and timing cannot be reasonably estimated as certain deposit accounts have early withdrawal rights and the option to roll interest payments into the balance.
- (2) Deposits due in less than one year include deposits with indeterminate maturities.
- (3) See Note 9: Long-Term Borrowings to our consolidated financial statements for further discussion. Total future payment of interest charges for the floating-rate notes is estimated to be \$392 million as of December 31, 2019, utilizing the current interest rates as of that date.
- (4) Purchase obligations for goods and services include payments under, among other things, consulting, outsourcing, data, advertising, sponsorship, software license, telecommunications agreements and global acceptance contracts. Purchase obligations also include payments under rewards program agreements with merchants. Purchase obligations at December 31, 2019 reflect the minimum purchase obligation under legally binding contracts with contract terms that are both fixed and determinable. These amounts exclude obligations for goods and services that already have been incurred and are reflected on our consolidated statement of financial condition.
- (5) Other liabilities include our expected benefit payments associated with our pension plan, the contingent liability associated with our other investments accounted for under the equity method and a commitment to purchase certain when-issued mortgage-backed securities under an agreement with the Delaware State Housing Authority as part of our community reinvestment initiatives.

As of December 31, 2019 our consolidated statement of financial condition reflects a liability for unrecognized tax benefits of \$61 million and approximately \$17 million of accrued interest and penalties. Since the ultimate amount and timing of any future cash settlements cannot be predicted with reasonable certainty, the estimated income tax obligations about which there is uncertainty have been excluded from the contractual obligations table. See Note 15: Income Taxes to our consolidated financial statements for further information concerning our tax obligations.

We extend credit for consumer loans, primarily arising from agreements with customers for unused lines of credit on certain credit cards and certain other loan products, provided there is no violation of conditions established in the related agreement. At December 31, 2019, our unused credit arrangements were approximately \$206.7 billion. These arrangements, substantially all of which we can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage, customer creditworthiness and loan qualification. In addition, in the ordinary course of business, we guarantee payment on behalf of subsidiaries relating to contractual obligations with external parties. The activities of the subsidiaries covered by any such guarantees are included in our consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk refers to the risk that a change in the level of one or more market prices, rates, indices, correlations or other market factors will result in losses for an investment position or portfolio. We are exposed to market risk primarily from changes in interest rates.

Interest Rate Risk

We borrow money from a variety of depositors and institutions in order to provide loans to our customers, as well as invest in other assets and our business. These loans and other assets earn interest, which we use to pay interest on the money borrowed. Our net interest income and, therefore, earnings, will be reduced if the interest rate earned on assets increases at a slower pace than the interest rate paid on our borrowings. Changes in interest rates and our

competitors' responses to those changes may influence customer payment rates, loan balances or deposit account activity. As a result, we may incur higher funding costs, which may decrease earnings.

Our interest rate risk management policies are designed to measure and manage the potential volatility of earnings that may arise from changes in interest rates by having a financing portfolio that reflects our mix of variable- and fixed-rate assets. To the extent that the repricing characteristics of the assets and liabilities in a particular portfolio are not sufficiently matched, we may utilize interest rate derivative contracts, such as swap agreements, to achieve our objectives. Interest rate swap agreements effectively convert the underlying asset or liability from fixed- to floating-rate or from floating- to fixed-rate. See Note 21: Derivatives and Hedging Activities to our consolidated financial statements for information on our derivatives activity.

We use an interest rate sensitivity simulation to assess our interest rate risk exposure. For purposes of presenting the possible earnings effect of a hypothetical, adverse change in interest rates over the 12-month period from our reporting date, we assume that all interest rate sensitive assets and liabilities will be impacted by a hypothetical, immediate 100 basis point change in interest rates relative to market consensus expectations as of the beginning of the period. The sensitivity is based upon the hypothetical assumption that all relevant types of interest rates would change instantaneously, simultaneously and to the same degree.

Our interest rate sensitive assets include our variable-rate loan receivables and the assets that make up our liquidity portfolio. We have limitations on our ability to mitigate interest rate risk by adjusting rates on existing balances and competitive actions may limit our ability to increase the rates that we charge to customers for new loans. At December 31, 2019, the majority of our credit card and student loans charge variable rates. Assets with rates that are fixed at period end but which will mature, or otherwise contractually reset to a market-based indexed rate or other fixed rate prior to the end of the 12-month period, are considered to be rate sensitive. The latter category includes certain revolving credit card loans that may be offered at below-market rates for an introductory period, such as balance transfers and special promotional programs, after which the loans will contractually reprice in accordance with our normal market-based pricing structure. For assets that have a fixed interest rate but contractually will, or are assumed to, reset to a market-based indexed rate or other fixed rate during the next 12 months, earnings sensitivity is measured from the expected repricing date. In addition, for all interest rate sensitive assets, earnings sensitivity is calculated net of expected loan losses, which for purposes of this analysis, are assumed to remain unchanged relative to our baseline expectations over the analysis horizon.

Interest rate sensitive liabilities are assumed to be those for which the stated interest rate is not contractually fixed for the next 12-month period. Thus, liabilities that vary with changes in a market-based index, such as the federal funds rate or London Interbank Offered Rate, which will reset before the end of the 12-month period, or liabilities whose rates are fixed at the fiscal period end but will mature and are assumed to be replaced with a market-based indexed rate prior to the end of the 12-month period, are also considered to be rate sensitive. For these fixed-rate liabilities, earnings sensitivity is measured from the expected maturity date.

Net interest income sensitivity requires assumptions to be made regarding market conditions, consumer behavior, and the overall growth and composition of the balance sheet. These assumptions are inherently uncertain and, as a result, actual earnings may differ from the simulated earnings presented below. Our actual earnings depend on multiple factors including, but not limited to, the direction and timing of changes in interest rates, the movement of short-term versus long-term rates, balance sheet composition, competitor actions affecting pricing decisions in our loans and deposits, and strategic actions undertaken by management.

The following table shows the impacts to net interest income over the following 12-month period that we estimate would result from an immediate and parallel change in interest rates affecting all interest rate sensitive assets and liabilities (dollars in millions):

Basis point change	At December 31, 2019		At December 31, 2018	
	\$	%	\$	%
+100	\$ 12	0.12 %	\$ 192	2.01 %
-100	\$ (13)	(0.13)%	\$ (194)	(2.03)%

Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of
Discover Financial Services
Riverwoods, IL

Opinion on Internal Control over Financial Reporting

We have audited the internal control over financial reporting of Discover Financial Services (the “Company”) as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated statement of financial condition, and the related consolidated statements of income, comprehensive income, changes in stockholders’ equity, and cash flows as of and for the year ended December 31, 2019, of the Company and our report dated February 26, 2020, expressed an unqualified opinion on those financial statements.

Basis for Opinion

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ DELOITTE & TOUCHE LLP

Chicago, Illinois
February 26, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of
Discover Financial Services
Riverwoods, IL

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of financial condition of Discover Financial Services (the "Company") as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows, for each of the three years in the period ended December 31, 2019, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2020, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current-period audit of the financial statements that were communicated or required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Allowance for Credit Card Loan Losses — Refer to Notes 2 and 4 to the financial statements

Critical Audit Matter Description

The Company originates unsecured credit card loans. At December 31, 2019, these loans totaled \$77 billion. The Company estimates and records an allowance for credit card loans that are impaired on a pool basis using credit loss models that incorporate historical loss data, current portfolio characteristics, and other qualitative factors. There was a significant amount of judgment required by management in selecting model inputs and in analyzing the results produced by the models to determine the recorded allowance.

Auditing the credit loss models and related inputs used to determine the allowance involved especially subjective auditor judgment due to the nature and extent of evidence provided and required significant effort, including the use of credit modeling specialists.

How the Critical Audit Matter Was Addressed in the Audit

Our audit procedures related to the allowance for credit card loan losses balance included the following procedures, among others:

- We tested the design and operating effectiveness of management’s controls over the allowance for loan losses including controls over data integrity and model assumptions.
- We tested the completeness and accuracy of the historical borrower data, including collection data, bankruptcy statistics, portfolio characteristics, and other data used in management’s models.
- We used our credit modeling specialists to assist us in evaluating the appropriateness of the models used to determine the allowance. We also evaluated the reasonableness of the economic assumptions used in the models by comparing such assumptions to independent sources.
- We evaluated the model results considering economic conditions, including recent trends in national credit card loan delinquencies and charge-offs data, and performed a peer analysis to evaluate the trends in the Company’s allowance for loan losses over time and as compared to its peers.
- We assessed the reasonableness of the model results by comparing modeled losses to actual historical losses.

Disclosure of Accounting Standard Update (“ASU”) 2016-13 Adoption — Refer to Note 1 to the financial statements

Critical Audit Matter Description

On January 1, 2020, the Company adopted ASU 2016-13, Financial Instruments–Credit Losses, which introduces a forward-looking “expected loss” model (the “Current Expected Credit Losses (CECL)” model) to estimate credit losses over the remaining expected life of the Company’s loan portfolio. Estimates of expected credit losses under the CECL model are based on relevant information about current conditions, historical experiences and reasonable and supportable forward-looking forecasts regarding collectability of the loan portfolio.

In order to estimate the expected credit losses, new credit loss models were implemented to align with the CECL model. Assumptions used to estimate expected credit losses under the CECL model included but were not limited to key economic assumptions applied over a reasonable and supportable forecast period, and for the credit card portfolio the application of a credit card payment allocation policy. The Company disclosed that the impact of adoption on January 1, 2020 will result in an increase of \$2.5 billion to the allowance for credit losses, an increase of \$0.6 billion to other assets and a \$1.9 billion decrease in retained earnings.

Given the estimation of credit losses significantly changes under the CECL model, including the application of new accounting policies, the use of new subjective judgments, and changes made to the loss estimation models, performing audit procedures to evaluate the disclosure of ASU 2016-13 adoption involved a high degree of auditor judgment and required significant effort, including the need to involve our credit specialists.

How the Critical Audit Matter Was Addressed in the Audit

Our audit procedures related to the disclosure of ASU 2016-13 adoption included the following procedures, among others:

- We tested the design and operating effectiveness of management’s controls over the CECL estimate including controls over data integrity, model assumptions and model validation.
- We evaluated the Company’s accounting policies, methodologies, and elections involved in the adoption of the CECL model.
- We tested the completeness and accuracy of the historical borrower data, including collection data, bankruptcy statistics, portfolio characteristics, and other data used in management’s models.
- We used our credit modeling specialists to assist us in evaluating the appropriateness of the models used to determine the CECL estimate and examine logic for selected components of the model.
- We also evaluated the reasonableness of the economic assumptions used in the models by comparing such assumptions to independent sources.
- We evaluated the reasonable and supportable forecast period over which the key economic assumptions are applied, by reviewing the historical accuracy of economic forecasts and other underlying economic information management used as the basis for the selected reasonable and supportable period.

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- For the credit card loan portfolio, we evaluated the assumption of how expected credit card payments are applied to existing credit card balances to determine if it is reasonable and consistent with the CECL standard. We used our credit modeling specialists to evaluate if the approach was consistently applied in the model in accordance with the Company's selected policy.
- We evaluated the completeness of the Company's disclosures related to adoption of ASU 2016-13.

/s/ DELOITTE & TOUCHE LLP

Chicago, Illinois
February 26, 2020

We have served as the Company's auditor since the spin-off from its former parent company in 2007 and as Discover Bank's (a wholly-owned subsidiary of the Company) auditor since 1985.

DISCOVER FINANCIAL SERVICES

Consolidated Statements of Financial Condition

	December 31,	
	2019	2018
	(dollars in millions, except share amounts)	
Assets		
Cash and cash equivalents	\$ 6,924	\$ 13,299
Restricted cash	40	1,846
Investment securities (includes \$10,323 and \$3,133 at fair value at December 31, 2019 and 2018, respectively)	10,595	3,370
Loan receivables		
Loan receivables	95,894	90,512
Allowance for loan losses	(3,383)	(3,041)
Net loan receivables	92,511	87,471
Premises and equipment, net	1,057	936
Goodwill	255	255
Intangible assets, net	155	161
Other assets	2,459	2,215
Total assets	\$ 113,996	\$ 109,553
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Interest-bearing deposit accounts	\$ 71,955	\$ 67,084
Non-interest bearing deposit accounts	791	675
Total deposits	72,746	67,759
Long-term borrowings	25,701	27,228
Accrued expenses and other liabilities	3,690	3,436
Total liabilities	102,137	98,423
Commitments, contingencies and guarantees (Notes 15, 18 and 19)		
Stockholders' Equity		
Common stock, par value \$0.01 per share; 2,000,000,000 shares authorized; 566,653,650 and 564,851,848 shares issued at December 31, 2019 and 2018, respectively	6	6
Preferred stock, par value \$0.01 per share; 200,000,000 shares authorized; 5,700 shares issued and outstanding and aggregate liquidation preference of \$570 at December 31, 2019 and 2018	563	563
Additional paid-in capital	4,206	4,130
Retained earnings	21,290	18,906
Accumulated other comprehensive loss	(119)	(156)
Treasury stock, at cost; 256,496,492 and 233,406,005 shares at December 31, 2019 and 2018, respectively	(14,087)	(12,319)
Total stockholders' equity	11,859	11,130
Total liabilities and stockholders' equity	\$ 113,996	\$ 109,553

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 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.

	December 31,	
	2019	2018
	(dollars in millions)	
Assets		
Restricted cash	\$ 40	\$ 1,846
Loan receivables	\$ 31,840	\$ 33,424
Allowance for loan losses allocated to securitized loan receivables	\$ (1,179)	\$ (1,150)
Other assets	\$ 5	\$ 7
Liabilities		
Long-term borrowings	\$ 14,284	\$ 16,917
Accrued expenses and other liabilities	\$ 15	\$ 18

See Notes to the Consolidated Financial Statements.

DISCOVER FINANCIAL SERVICES

Consolidated Statements of Income

	For the Years Ended December 31,		
	2019	2018	2017
	(dollars in millions, except per share amounts)		
Interest income			
Credit card loans	\$ 9,690	\$ 8,835	\$ 7,907
Other loans	1,871	1,726	1,560
Investment securities	179	40	27
Other interest income	253	292	154
Total interest income	11,993	10,893	9,648
Interest expense			
Deposits	1,587	1,238	846
Long-term borrowings	943	901	802
Total interest expense	2,530	2,139	1,648
Net interest income	9,463	8,754	8,000
Provision for loan losses	3,231	3,035	2,579
Net interest income after provision for loan losses	6,232	5,719	5,421
Other income			
Discount and interchange revenue, net	1,066	1,074	1,052
Protection products revenue	194	204	223
Loan fee income	449	402	363
Transaction processing revenue	197	178	167
Other income	90	97	92
Total other income	1,996	1,955	1,897
Other expense			
Employee compensation and benefits	1,738	1,627	1,512
Marketing and business development	883	857	776
Information processing and communications	409	350	315
Professional fees	753	672	655
Premises and equipment	107	102	99
Other expense	503	469	424
Total other expense	4,393	4,077	3,781
Income before income tax expense	3,835	3,597	3,537
Income tax expense	878	855	1,438
Net income	\$ 2,957	\$ 2,742	\$ 2,099
Net income allocated to common stockholders	\$ 2,908	\$ 2,689	\$ 2,031
Basic earnings per common share	\$ 9.09	\$ 7.81	\$ 5.43
Diluted earnings per common share	\$ 9.08	\$ 7.79	\$ 5.42

See Notes to the Consolidated Financial Statements.

DISCOVER FINANCIAL SERVICES
Consolidated Statements of Comprehensive Income

	For the Years Ended December 31,		
	2019	2018	2017
	(dollars in millions)		
Net income	\$ 2,957	\$ 2,742	\$ 2,099
Other comprehensive income, net of tax			
Unrealized gains (losses) on available-for-sale investment securities, net of tax	102	16	(2)
Unrealized (losses) gains on cash flow hedges, net of tax	(39)	9	23
Unrealized pension and post-retirement plan (losses) gains, net of tax	(26)	—	(12)
Other comprehensive income	37	25	9
Comprehensive income	<u>\$ 2,994</u>	<u>\$ 2,767</u>	<u>\$ 2,108</u>

See Notes to the Consolidated Financial Statements.

DISCOVER FINANCIAL SERVICES

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					
(dollars in millions, shares in thousands)									
Balance at December 31, 2016	575	\$ 560	562,414	\$ 5	\$ 3,962	\$ 15,130	\$ (161)	\$ (8,173)	\$ 11,323
Net income	—	—	—	—	—	2,099	—	—	2,099
Other comprehensive income	—	—	—	—	—	—	9	—	9
Purchases of treasury stock	—	—	—	—	—	—	—	(2,081)	(2,081)
Common stock issued under employee benefit plans	—	—	79	—	5	—	—	—	5
Common stock issued and stock-based compensation expense	—	—	1,005	1	75	—	—	—	76
Dividends — common stock (\$1.30 per share)	—	—	—	—	—	(490)	—	—	(490)
Dividends — Series B preferred stock (\$65.00 per share)	—	—	—	—	—	(37)	—	—	(37)
Redemption of Series B preferred stock	(575)	(560)	—	—	—	(15)	—	—	(575)
Issuance of Series C preferred stock, net of issuance costs	6	563	—	—	—	—	—	—	563
Balance at December 31, 2017	6	563	563,498	6	4,042	16,687	(152)	(10,254)	10,892
Cumulative effect of ASU No. 2018-02 adoption	—	—	—	—	—	29	(29)	—	—
Net income	—	—	—	—	—	2,742	—	—	2,742
Other comprehensive income	—	—	—	—	—	—	25	—	25
Purchases of treasury stock	—	—	—	—	—	—	—	(2,065)	(2,065)
Common stock issued under employee benefit plans	—	—	96	—	6	—	—	—	6
Common stock issued and stock-based compensation expense	—	—	1,258	—	82	—	—	—	82
Dividends — common stock (\$1.50 per share)	—	—	—	—	—	(521)	—	—	(521)
Dividends — Series C preferred stock (\$5,500 per share)	—	—	—	—	—	(31)	—	—	(31)
Balance at December 31, 2018	6	563	564,852	6	4,130	18,906	(156)	(12,319)	11,130
Net income	—	—	—	—	—	2,957	—	—	2,957
Other comprehensive income	—	—	—	—	—	—	37	—	37
Purchases of treasury stock	—	—	—	—	—	—	—	(1,768)	(1,768)
Common stock issued under employee benefit plans	—	—	97	—	7	—	—	—	7
Common stock issued and stock-based compensation expense	—	—	1,705	—	69	—	—	—	69
Dividends — common stock (\$1.68 per share)	—	—	—	—	—	(542)	—	—	(542)
Dividends — Series C preferred stock (\$5,500 per share)	—	—	—	—	—	(31)	—	—	(31)
Balance at December 31, 2019	6	\$ 563	566,654	\$ 6	\$ 4,206	\$ 21,290	\$ (119)	\$ (14,087)	\$ 11,859

See Notes to the Consolidated Financial Statements.

DISCOVER FINANCIAL SERVICES

Consolidated Statements of Cash Flows

For the Years Ended December 31,

	2019	2018	2017
(dollars in millions)			
Cash flows from operating activities			
Net income	\$ 2,957	\$ 2,742	\$ 2,099
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	3,231	3,035	2,579
Depreciation and amortization	436	435	393
Amortization of deferred revenues and accretion of accretable yield on acquired loans	(421)	(403)	(399)
Net loss on investments and other assets	37	45	55
Other, net	(51)	(107)	361
Changes in assets and liabilities			
Increase in other assets	(202)	(7)	(502)
Increase (decrease) in accrued expenses and other liabilities	209	(549)	622
Net cash provided by operating activities	<u>6,196</u>	<u>5,191</u>	<u>5,208</u>
Cash flows from investing activities			
Maturities of other short-term investments	1,000	—	—
Purchases of other short-term investments	(1,000)	—	—
Maturities of available-for-sale investment securities	140	838	200
Purchases of available-for-sale investment securities	(7,183)	(2,554)	—
Maturities of held-to-maturity investment securities	31	18	16
Purchases of held-to-maturity investment securities	(66)	(82)	(40)
Net principal disbursed on loans originated for investment	(7,844)	(8,480)	(8,701)
Proceeds from returns of investment	—	—	17
Purchases of other investments	(68)	(65)	(65)
Purchases of premises and equipment	(284)	(254)	(218)
Net cash used for investing activities	<u>(15,274)</u>	<u>(10,579)</u>	<u>(8,791)</u>
Cash flows from financing activities			
Proceeds from issuance of securitized debt	3,519	4,766	5,059
Maturities and repayment of securitized debt	(6,287)	(4,447)	(4,959)
Proceeds from issuance of other long-term borrowings	1,340	2,233	1,127
Maturities and repayment of other long-term borrowings	(286)	(1,756)	(404)
Proceeds from issuance of common stock	7	6	5
Purchases of treasury stock	(1,768)	(2,065)	(2,081)
Net increase in deposits	4,945	8,961	6,753
Proceeds from issuance of preferred stock	—	—	563
Payments on redemption of preferred stock	—	—	(575)
Dividends paid on common and preferred stock	(573)	(552)	(527)
Net cash provided by financing activities	<u>897</u>	<u>7,146</u>	<u>4,961</u>
Net (decrease) increase in cash, cash equivalents and restricted cash	<u>(8,181)</u>	<u>1,758</u>	<u>1,378</u>
Cash, cash equivalents and restricted cash, at beginning of period	15,145	13,387	12,009
Cash, cash equivalents and restricted cash, at end of period	<u>\$ 6,964</u>	<u>\$ 15,145</u>	<u>\$ 13,387</u>
Reconciliation of cash, cash equivalents and restricted cash			
Cash and cash equivalents	\$ 6,924	\$ 13,299	\$ 13,306
Restricted cash	40	1,846	81
Cash, cash equivalents and restricted cash, at end of period	<u>\$ 6,964</u>	<u>\$ 15,145</u>	<u>\$ 13,387</u>
Supplemental disclosures of cash flow information			
Cash paid during the period for			
Interest expense	\$ 2,407	\$ 1,847	\$ 1,396
Income taxes, net of income tax refunds	\$ 1,088	\$ 650	\$ 1,424

See Notes to the Consolidated Financial Statements.

Notes to the Consolidated Financial Statements

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 and debit cards and 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 merchant acceptance 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 activities are managed in two segments, Direct Banking and Payment Services, based on the products and services provided. For a detailed description of the operations of each segment, as well as the allocation conventions used in business segment reporting, see Note 22: Segment Disclosures.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related disclosures. These estimates are based on information available as of the date of the consolidated financial statements. The Company believes that the estimates used in the preparation of the consolidated financial statements are reasonable. Actual results could differ from these estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. The Company’s policy is to consolidate all entities in which it owns more than 50% of the outstanding voting stock unless it does not control the entity. However, the Company did not have a controlling voting interest in any entity other than its wholly-owned subsidiaries in the periods presented in the accompanying consolidated financial statements.

It is also the Company’s policy to consolidate any VIE for which the Company is the primary beneficiary, as defined by GAAP. On this basis, the Company consolidates the Discover Card Master Trust I (“DCMT”) and the Discover Card Execution Note Trust (“DCENT”) as well as two student loan securitization trusts. The Company is deemed to be the primary beneficiary of each of these trusts since it is, for each, the trust servicer and the holder of both the residual interest and the majority of the most subordinated interests. Because of those involvements, the Company has, for each trust, (i) the power to direct the activities that most significantly impact the economic performance of the trust and (ii) the obligation (or right) to absorb losses (or receive benefits) of the trust that could potentially be significant. The Company has determined that it was not the primary beneficiary of any other VIE during the years ended December 31, 2019, 2018 and 2017.

For investments in any entities in which the Company owns 50% or less of the outstanding voting stock but in which the Company has significant influence over operating and financial decisions, the Company applies the equity method of accounting. The Company also applies the equity method to its investments in qualified affordable housing projects and similar tax credit partnerships. In cases where the Company’s equity investment is less than 20% and significant influence does not exist, such investments are carried at cost, adjusted for any impairment in value.

Recently Issued Accounting Pronouncements (Not Yet Adopted)

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The FASB also issued subsequent ASUs that clarify the scope and provide additional guidance. This ASU replaces the incurred loss model with the current expected credit loss (“CECL”) approach. For loans carried at amortized cost, the

allowance for loan losses will be based on management's current estimate of all expected credit losses over the remaining contractual term of the loans. Upon the origination of a loan, the Company will record its estimate of all expected credit losses on that loan through an immediate charge to earnings. Updates to that estimate each period will be recorded through provision expense. The CECL estimate is to be based on historical experience, current conditions and reasonable and supportable forecasts.

The CECL approach is expected to increase the Company's allowance for loan losses as a result of: (1) recording reserves for expected losses, not simply those deemed to be already incurred, (2) extending the loss estimate period over the entire life of the loan and (3) presenting the credit loss component of the purchased credit-impaired ("PCI") loan portfolio in the allowance for loan losses rather than embedding it within the loan carrying value. The allowance for loan losses on all loans carried at amortized cost, including loans previously referred to as PCI loans and loans modified in a troubled debt restructuring ("TDR") will be measured under the CECL approach. Previous specialized measurement guidance for PCI loans, which the ASU refers to as purchased credit-deteriorated ("PCD"), and TDRs will be eliminated, although certain separate disclosure guidance will be retained.

Measurement of credit impairment of available-for-sale debt securities will generally remain unchanged under the new rules, but any credit impairment will be recorded through an allowance, rather than a direct write-down of the security. The Company invests in U.S. Treasury and residential mortgage-backed securities issued by government agencies, which have long histories with no credit losses and are explicitly or implicitly guaranteed by the U.S. government. Therefore, management has concluded that there is no expectation of non-payment on its investment securities and will not record an allowance for credit losses on these investments.

The ASU is effective for the Company on January 1, 2020 and requires modified-retrospective application, meaning a cumulative-effect adjustment is recorded as of the effective date without adjusting comparative periods. Management is prepared to implement the standard and will record the following as a result of adoption:

- A \$2.5 billion increase to the allowance for loan losses primarily representing the adjustment for recording reserves for expected losses, not simply those deemed to be already incurred, and extending the loss estimate period over the entire life of the loan;
- A \$0.6 billion increase to other assets related to deferred tax assets on the larger allowance for loan losses;
- An offsetting \$1.9 billion decrease, net of tax, to the opening balance of retained earnings; and
- Immaterial adjustments to the following:
 - The carrying value of PCD loans and related accrued interest reflected in other assets; and
 - Accrued expenses and other liabilities to record reserves for unfunded commitments.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The guidance requires lessees to capitalize most leases on their balance sheet whereas under previous GAAP, only leases previously identified as capital leases were recognized on the lessee's balance sheet. Leases previously identified as capital leases are generally identified as financing leases under the new guidance but otherwise their accounting treatment remains relatively unchanged. Leases previously identified as operating leases generally remain in that category under the new standard, but both a right-of-use asset and a liability for remaining lease payments are required to be recognized on the balance sheet for this type of lease. The manner in which expenses associated with all leases are reported on the income statement remains mostly unchanged. Lessor accounting also remains substantially unchanged by the new standard. The new guidance became effective for the Company on January 1, 2019 and, as permitted by the standard, management elected to recognize a cumulative-effect adjustment as of the effective date without adjusting comparative prior periods. Additionally, management elected the practical expedients to not reassess prior conclusions related to (1) contracts containing leases, (2) lease classification and (3) initial direct costs. Management also made an accounting policy election to exclude short-term leases of one year or less from the balance sheet. As a result of adoption, the Company recorded immaterial adjustments to other assets and accrued expenses and other liabilities to recognize operating lease right-of-use assets of \$49 million and operating lease liabilities of \$56 million, respectively. Leases are not material to the Company or its consolidated financial statements.

2. Summary of Significant Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents is defined by the Company as cash on deposit with banks, including time deposits and other highly liquid investments, with maturities of 90 days or less when purchased. Cash and cash equivalents included \$959 million and \$728 million of cash and due from banks and \$6.0 billion and \$12.6 billion of interest-earning deposits at other banks at December 31, 2019 and 2018, respectively.

Restricted Cash

Restricted cash includes cash for which the Company's ability to withdraw funds at any time is contractually limited. Restricted cash is generally designated for specific purposes arising out of certain contractual or other obligations.

Investment Securities

At December 31, 2019, investment securities consisted of U.S. Treasury obligations and mortgage-backed securities issued by government agencies. Investment securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and are reported at amortized cost. All other investment securities are classified as available-for-sale, as the Company does not hold investment securities for trading purposes. Available-for-sale investment securities are reported at fair value with unrealized gains and losses, net of tax, reported as a component of accumulated other comprehensive income ("AOCI") included in stockholders' equity. The Company estimates the fair value of available-for-sale investment securities as more fully discussed in Note 20: Fair Value Measurements. The amortized cost for each held-to-maturity and available-for-sale investment security is adjusted for amortization of premiums or accretion of discounts, as appropriate. Such amortization or accretion is included in interest income. The Company evaluates its unrealized loss positions for other-than-temporary impairment in accordance with GAAP applicable for investments in debt securities. Realized gains and losses and the credit loss portion of other-than-temporary impairments related to investment securities are determined at the individual security level and are reported in other income.

Loan Receivables

Loan receivables consist of credit card receivables, other loans and PCI loans. Loan receivables also include unamortized net deferred loan origination fees and costs (also see "— Significant Revenue Recognition Accounting Policies — Loan Interest and Fee Income"). Credit card loan receivables are reported at their principal amounts outstanding and include uncollected billed interest and fees and are reduced for unearned revenue related to balance transfer fees (also see "— Significant Revenue Recognition Accounting Policies — Loan Interest and Fee Income"). Other loans consist of student loans, personal loans and other loans and are reported at their principal amounts outstanding. For student loans, principal amounts outstanding also include accrued interest that has been capitalized. The Company's loan receivables are deemed to be held for investment at origination or acquisition because management has the intent and ability to hold them for the foreseeable future. Cash flows associated with loans originated or acquired for investment are classified as cash flows from investing activities, regardless of a subsequent change in intent.

Purchased Credit-Impaired Loans

PCI loans are loans acquired at prices that reflected a discount related to deterioration in individual loan credit quality since origination. The Company's PCI loans are comprised entirely of acquired private student loans.

The PCI student loans were aggregated into pools based on common risk characteristics at the time of their acquisition. Loans were grouped primarily on the basis of origination date as loans originated in a particular year generally reflect the application of common origination strategies and/or underwriting criteria. Each pool is accounted for as a single asset and each has a single composite interest rate, total contractual cash flows and total expected cash flows.

Interest income on PCI loans is recognized on the basis of expected cash flows rather than contractual cash flows. The total amount of interest income recognizable on a pool of PCI loans (i.e., its accretable yield) is the difference between the carrying amount of the loan pool and the future cash flows expected to be collected without regard to whether the expected cash flows represent principal or interest collections. Interest is recognized on an effective yield basis over the life of the loan pool.

The initial estimates of the fair value of the PCI student loans included the impact of expected credit losses, and therefore, no allowance for loan losses was recorded as of the purchase dates. The difference between contractually required cash flows and cash flows expected to be collected, as measured at the acquisition dates, is not permitted to be accreted. Charge-offs are absorbed by this non-accretable difference and do not result in a charge to earnings. However, as noted below, a charge to provision expense may be necessary to the extent that expected credit losses increase after the acquisition date.

The estimate of cash flows expected to be collected is evaluated each reporting period to ensure it reflects management's latest expectations of future credit losses and borrower prepayments, and interest rates in effect in the current period. To the extent expected credit losses increase after the acquisition dates, the Company will record an allowance for loan losses through the provision for loan losses, which will reduce net income. Changes in expected cash flows related to changes in prepayments or interest rate indices for variable-rate loans generally are recorded prospectively as adjustments to interest income.

To the extent that a significant increase in cash flows due to lower expected losses is deemed probable, the Company will first reverse any previously established allowance for loan losses and then increase the amount of remaining accretable yield. The increase to yield would be recognized prospectively over the remaining life of the loan pool. An increase in the accretable yield would reduce the remaining non-accretable difference available to absorb subsequent charge-offs. Disposals of loans, which may include sales of loans or receipt of payments in full from the borrower or charge-offs, result in removal of the loans from their respective pools.

Delinquent Loans and Charge-Offs

The entire balance of an account is contractually past due if the minimum payment is not received by the specified date on the customer's billing statement. Delinquency is reported on loans that are 30 days or more past due.

Credit card loans are charged off at the end of the month during which an account becomes 180 days past due. Closed-end consumer loan receivables are charged off at the end of the month during which an account becomes 120 days contractually past due. Customer bankruptcies and probate accounts are charged off by the end of the month 60 days following the receipt of notification of the bankruptcy or death, but not later than the 180-day or 120-day time frame described above. Receivables associated with alleged or potential fraudulent transactions are adjusted to their net realizable value upon receipt of notification of such fraud through a charge to other expense and are subsequently written off at the end of the month 90 days following notification, but not later than the contractual 180-day or 120-day time frame described above. The Company's charge-off policies are designed to comply with guidelines established by the Federal Financial Institutions Examination Council ("FFIEC").

The Company's net charge-offs include the principal amount of loans charged off less principal recoveries and exclude charged-off interest and fees, recoveries of interest and fees and fraud losses.

The practice of re-aging an account also may affect loan delinquencies and charge-offs. A re-age is intended to assist delinquent customers who have experienced financial difficulties but who demonstrate both an ability and willingness to repay. Accounts meeting specific criteria are re-aged when the Company and the customer agree on a temporary repayment schedule that may include concessionary terms. With re-aging, the outstanding balance of a delinquent account is returned to a current status. Customers may also qualify for a workout re-age when either a longer term or permanent hardship exists. The Company's re-age practices are designed to comply with FFIEC guidelines.

Allowance for Loan Losses

The Company maintains an allowance for loan losses at a level that is appropriate to absorb probable losses inherent in the loan portfolio. The estimate of probable incurred losses considers uncollectible principal, interest and fees associated with the Company's loan receivables. The allowance is evaluated quarterly for appropriateness and is maintained through an adjustment to the provision for loan losses. Charge-offs of principal amounts of loans outstanding are deducted from the allowance and subsequent recoveries of such amounts increase the allowance. Charge-offs of loan balances representing unpaid interest and fees result in a reversal of interest and fee income, respectively, which is effectively a reclassification of the provision for loan losses (also see "— Significant Revenue Recognition Accounting Policies — Loan Interest and Fee Income").

The Company calculates its allowance for loan losses by estimating probable losses separately for classes of the loan portfolio with similar loan characteristics, which generally results in segmenting the portfolio by loan product type.

The Company bases its allowance for loan losses on several analyses that help estimate incurred losses as of the balance sheet date. While the Company's estimation process includes historical data and analysis, there is a significant amount of judgment applied in selecting inputs and analyzing the results produced by the models to determine the allowance. For substantially all of its loan receivables, the Company uses a migration analysis to estimate the likelihood that a loan will progress through the various stages of delinquency. The Company uses other analyses to estimate losses incurred on non-delinquent and bankrupt accounts. The considerations in these analyses include past and current loan performance, loan growth and seasoning, current risk management practices, account collection strategies, economic conditions, bankruptcy filings, policy changes and forecasting uncertainties. Consideration of past and current loan performance includes the post-modification performance of loans modified in a troubled debt restructuring. For the majority of its portfolio, the Company estimates its allowance for loan losses on a pooled basis, which includes loans that are delinquent and/or no longer accruing interest and/or certain loans that have defaulted from a loan modification program.

As part of certain collection strategies, the Company may modify the terms of loans to customers experiencing financial hardship. 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 accounted for as troubled debt restructurings. The Company classifies a modified loan in which a concession has been granted to the borrower as a troubled debt restructuring based on the cumulative length of the concession period and credit quality of the borrower.

Loan receivables, other than PCI loans, that have been modified under a troubled debt restructuring are evaluated separately from the pools of receivables that are subject to the collective analyses described above. Loan receivables modified in a troubled debt restructuring are recorded at their present values with impairment measured as the difference between the recorded investment in the loan and the discounted present value of cash flows expected to be collected. Consistent with the Company's measurement of impairment of modified loans on a pooled basis, the discount rate used for credit card loans in internal programs is the average current annual percentage rate applied to non-impaired credit card loans, which approximates what would have applied to the pool of modified loans prior to modification. The discount rate used for credit card loans in external programs reflects a rate that is consistent with rates offered to cardmembers not in a program that have similar risk characteristics. For student and personal loans, the discount rate used is the average contractual rate prior to modification. Changes in the present value are recorded in the provision for loan losses. All of the Company's troubled debt restructurings, which are evaluated collectively on an aggregated (by loan type) basis, have a related allowance for loan losses.

Premises and Equipment, net

Premises and equipment, net, are stated at cost less accumulated depreciation and amortization, which is computed using the straight-line method over the estimated useful lives of the assets. Buildings are depreciated over a period of 39 years. The costs of improvements are capitalized and depreciated either over the asset's estimated useful life, typically ten years to fifteen years, or over the remaining term of the lease, when applicable. Furniture and fixtures are depreciated over a period of five years to ten years. Equipment is depreciated over three years to ten years. Maintenance and repairs are immediately expensed, while the costs of improvements are capitalized.

Purchased software and capitalized costs related to internally developed software are amortized over their useful lives of three years to ten years. Costs incurred during the application development stage related to internally developed software are capitalized. Costs are expensed as incurred during the preliminary project stage and post implementation stage. Once the capitalization criteria as defined in GAAP have been met, external direct costs incurred for materials and services used in developing or obtaining internal-use computer software and payroll and payroll-related costs for employees who are directly associated with the internal-use computer software project (to the extent those employees devoted time directly to the project) are capitalized. Amortization of capitalized costs begins when the software is ready for its intended use. Capitalized software is included in premises and equipment, net in the Company's consolidated statements of financial condition. See Note 6: Premises and Equipment for further information about the Company's premises and equipment.

Cloud computing arrangements involving the licensing of software that meet certain criteria are recognized as the acquisition of software. Such assets are measured at the present value of the license obligation, if the license is to be paid over time, in addition to any capitalized upfront costs and amortized over the life of the arrangement. Cloud computing arrangements that do not meet the criteria to be recognized as acquired software are accounted for as service contracts. To date, none of the Company's cloud computing arrangements have met the criteria to be recognized as acquired software.

Premises and equipment are subject to impairment testing when events or conditions indicate that the carrying value of the asset may not be fully recoverable from future cash flows. See “— Intangible Assets” for additional details on impairment testing.

Goodwill

Goodwill is recorded as part of the Company’s acquisitions of businesses when the purchase price exceeds the fair value of the net tangible and separately identifiable intangible assets acquired. The Company’s goodwill is not amortized, but rather is subject to an impairment test at the reporting unit level annually as of October 1, or between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company’s reported goodwill relates to PULSE, which it acquired in 2005. The Company’s goodwill is tested for impairment by comparing the fair value of the reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is not impaired. If the carrying value exceeds its fair value, an impairment loss must be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. No impairment was identified during the impairment test conducted as of October 1, 2019.

Intangible Assets

The Company’s identifiable intangible assets consist of both amortizable and non-amortizable intangible assets. The Company’s amortizable intangible assets consist primarily of acquired customer relationships and certain trade name intangibles. All of the Company’s amortizable intangible assets are carried at net book value and are amortized over their estimated useful lives. The amortization periods approximate the periods over which the Company expects to generate future net cash inflows from the use of these assets. The Company’s policy is to amortize intangibles in a manner that reflects the pattern in which the projected net cash inflows to the Company are expected to occur, where such pattern can be reasonably determined, as opposed to the straight-line basis. This method of amortization typically results in a greater portion of the intangible asset being amortized in the earlier years of its useful life.

All of the Company’s amortizable intangible assets, as well as other amortizable or depreciable long-lived assets such as premises and equipment, are subject to impairment testing when events or conditions indicate that the carrying value of the asset may not be fully recoverable from future cash flows. A test for recoverability is done by comparing the asset’s carrying value to the sum of the undiscounted future net cash inflows expected to be generated from the use of the asset over its remaining useful life. Impairment exists if the sum of the undiscounted expected future net cash inflows is less than the carrying amount of the asset. Impairment would result in a write-down of the asset to its estimated fair value. The estimated fair values of these assets are based on the discounted present value of the stream of future net cash inflows expected to be derived over the remaining useful lives of the assets. If an impairment write-down is recorded, the remaining useful life of the asset will be evaluated to determine whether revision of the remaining amortization or depreciation period is appropriate.

The Company’s non-amortizable intangible assets consist primarily of the brand-related intangibles and international transaction processing rights included in the acquisition of Diners Club. These assets are deemed to have indefinite useful lives and are therefore not subject to amortization. All of the Company’s non-amortizable intangible assets are subject to a test for impairment annually as of October 1, or more frequently if events or changes in circumstances indicate that the asset might be impaired. As required by GAAP, if the carrying value of a non-amortizable intangible asset is in excess of its fair value, the asset must be written down to its fair value through the recognition of an impairment charge to earnings. In contrast to amortizable intangibles, there is no test for recoverability associated with the impairment test for non-amortizable intangible assets. No significant impairment concerns were identified during the impairment test conducted as of October 1, 2019.

Stock-based Compensation

The Company measures the cost of employee services received in exchange for an award of stock-based compensation based on the grant-date fair value of the award. The cost, net of estimated forfeitures, is recognized over the requisite service period. Awards to employees who are retirement-eligible at any point during the year are amortized over 12 months in accordance with the vesting terms that apply under those circumstances. No compensation cost is recognized for awards that are subsequently forfeited.

Advertising Costs

The Company expenses television and radio advertising costs in the period in which the advertising is first aired and all other advertising costs as incurred. Advertising costs are recorded in marketing and business development and were \$264 million, \$258 million and \$219 million for the years ended December 31, 2019, 2018 and 2017, respectively.

Income Taxes

Income tax expense is provided for using the asset and liability method, under which deferred tax assets and liabilities are determined based on the temporary differences between the financial statement and income tax bases of assets and liabilities using currently enacted tax rates. Deferred tax assets are recognized when their realization is determined to be more likely than not. Uncertain tax positions are measured at the highest amount of tax benefit for which realization is judged to be more likely than not. Tax benefits that do not meet these criteria are unrecognized tax benefits. See Note 15: Income Taxes for more information about the Company's income taxes.

Financial Instruments Used for Asset and Liability Management

The Company utilizes derivative financial instruments to manage its various exposures to changes in fair value of certain assets and liabilities, variability in future cash flows arising from changes in interest rates or other types of forecasted transactions, and changes in foreign exchange rates. All derivatives are carried at their estimated fair values on the Company's consolidated statements of financial condition. Derivatives having gross positive fair values, inclusive of net accrued interest receipts or payments, are recorded in other assets. Derivatives with gross negative fair values, inclusive of net accrued interest payments or receipts, are recorded in accrued expenses and other liabilities. The methodologies used to estimate the fair values of these derivative financial instruments are described in Note 20: Fair Value Measurements. Variation margin payments associated with derivative positions that are cleared through an exchange are legally characterized as settlements of the derivative positions. Such settlement payments are reflected as offsets to the associated derivatives balances recorded in other assets or in accrued expenses and other liabilities. The impact of settlement payments on the consolidated statements of financial condition is discussed in more detail in Note 21: Derivatives and Hedging Activities. Other cash collateral receivable or payable amounts associated with derivatives are not offset against the fair value of these derivatives, but are recorded separately in other assets or deposits, respectively.

Certain of these instruments are designated and qualify for hedge accounting. A hedge is deemed effective to the extent that the change in fair value, cash flow, or net investment of the hedged item is offset by changes in the hedging instrument. Under cash flow hedge accounting, changes in the fair values of the derivative instruments are recognized in other comprehensive income ("OCI") and subsequently reclassified to earnings in the period the hedged forecasted cash flows affect earnings. In a net investment hedge, amounts accumulated in OCI are reclassified into earnings when a hedged net investment is either sold or substantially liquidated. Under fair value hedge accounting, changes in both (i) the fair values of the derivative instruments and (ii) the fair values of the hedged items relating to the risks being hedged, including net differences, if any, are recorded in interest expense. Certain other derivatives are not designated as hedges or do not qualify for hedge accounting; changes in the fair value of these derivatives are recorded in other income. These transactions are discussed in more detail in Note 21: Derivatives and Hedging Activities.

Accumulated Other Comprehensive Income

The Company records unrealized gains and losses on available-for-sale securities, changes in the fair value of cash flow hedges, and certain pension and foreign currency translation adjustments in OCI on an after-tax basis where applicable. The Company's policy is to adjust the tax effects of a component of AOCI in the same period in which the item is sold or otherwise derecognized, or when the carrying value of the item is remeasured. Details of OCI, net of tax, are presented in the statement of comprehensive income, and a rollforward of AOCI is presented in the statement of changes in stockholders' equity and Note 13: Accumulated Other Comprehensive Income.

Significant Revenue Recognition Accounting Policies

Loan Interest and Fee Income

Interest on loans is comprised largely of interest on credit card loans and is recognized based on the amount of loans outstanding and their contractual interest rate. Interest on credit card loans is included in loan receivables when billed to the customer. The Company accrues unbilled interest revenue each month from a customer's billing cycle date to the end of the month. The Company applies an estimate of the percentage of loans that will revolve in the next cycle

in the estimation of the accrued unbilled portion of interest revenue that is included in accrued interest receivable on the consolidated statements of financial condition. Interest on other loan receivables is accrued each month in accordance with their contractual terms and recorded in accrued interest receivable, which is included in other assets, in the consolidated statements of financial condition. Interest related to PCI loans is discussed in Note 4: Loan Receivables.

The Company recognizes fees (except balance transfer fees and certain product fees) on loan receivables in interest income or loan fee income as the fees are assessed. Balance transfer fees and certain product fees are recognized in interest income or loan fee income ratably over the periods to which they relate. Balance transfer fees are accreted to interest income over the life of the related balance. As of December 31, 2019 and 2018, deferred revenues related to balance transfer fees, recorded as a reduction of loan receivables, were \$67 million and \$52 million, respectively. Loan fee income consists of fees on credit card loans and includes late, cash advance, returned check and other miscellaneous fees and is reflected net of waivers and charge-offs.

Direct loan origination costs on credit card loans are deferred and amortized on a straight-line basis over a one year period and recorded in interest income from credit card loans. Direct loan origination costs on other loan receivables are deferred and amortized over the life of the loan using the interest method and are recorded in interest income from other loans. As of December 31, 2019 and 2018, the remaining unamortized deferred costs related to loan origination were \$178 million and \$138 million, respectively, and were recorded in loan receivables.

The Company accrues interest and fees on loan receivables until the loans are paid or charged off, except in instances of customer bankruptcy, death or fraud, where no further interest and fee accruals occur following notification. Credit card and closed-end consumer loan receivables are placed on non-accrual status upon receipt of notification of the bankruptcy or death of a customer or suspected fraudulent activity on an account. Upon completion of the fraud investigation, non-fraudulent credit card and closed-end consumer loan receivables may resume accruing interest. Payments received on non-accrual loans are allocated according to the same payment hierarchy applied to loans that are accruing interest. When loan receivables are charged off, unpaid accrued interest and fees are reversed against the income line items in which they were originally recorded in the consolidated statements of income. Charge-offs and recoveries of amounts that relate to capitalized interest on student loans are treated as principal charge-offs and recoveries, affecting the provision for loan losses rather than interest income. The Company considers uncollectible interest and fee revenues in assessing the adequacy of the allowance for loan losses.

Interest income from loans individually evaluated for impairment, including loans accounted for as troubled debt restructurings, is accounted for in the same manner as other accruing loans. Cash collections on these loans are allocated according to the same payment hierarchy methodology applied to loans that are not in such programs.

Discount and Interchange Revenue

The Company earns discount revenue from fees charged to merchants with whom it has entered into card acceptance agreements for processing credit card purchase transactions. The Company earns acquirer interchange revenue primarily from merchant acquirers on all Discover Network, Diners Club and PULSE transactions made by credit and debit card customers at merchants with whom merchant acquirers have entered into card acceptance agreements for processing payment card transactions. These card acceptance arrangements generally renew automatically and do not have fixed durations. Under these agreements, the Company stands ready to process payment transactions as and when each is presented. The Company earns discount, interchange and similar fees only when transactions are processed. Contractually defined per-transaction fee amounts typically apply to each type of transaction processed and are recognized as revenue at the time each transaction is captured for settlement. These fees are typically collected by the Company as part of the process of settling transactions daily with merchants and acquirers and are fully earned at the time settlement is made.

The Company pays issuer interchange to card-issuing entities that have entered into contractual arrangements to issue cards on the Discover Network and on certain transactions on the Diners Club and PULSE networks. This cost is contractually established and is based on the card-issuing organization's transaction volume. The Company classifies this cost as a reduction of discount and interchange revenue. Costs of cardholder reward arrangements, including the Cashback Bonus reward program, are classified as reductions of discount and interchange revenue pursuant to guidance under Accounting Standards Codification ("ASC") Topic 606 governing consideration payable to a customer. For both issuer interchange and cardholder rewards, the Company accrues the cost at the time each underlying card transaction is captured for settlement.

Customer Rewards

The Company offers its customers various reward programs, including the *Cashback Bonus* reward program, pursuant to which the Company pays certain customers a reward equal to a percentage of their credit card purchase amounts based on the type and volume of the customer's purchases. The liability for customer rewards, which is included in accrued expenses and other liabilities on the consolidated statements of financial condition, is recorded on an individual customer basis and is accumulated as qualified customers earn rewards through their ongoing credit card purchase activity or other defined actions. The Company recognizes customer rewards costs as a reduction of the related revenue, if any. In instances where a reward is not associated with a revenue-generating transaction, such as when a reward is given for opening an account, the reward cost is recorded as an operating expense. For the years ended December 31, 2019, 2018 and 2017, rewards costs amounted to \$1.9 billion, \$1.8 billion and \$1.6 billion, respectively. The liability for customer rewards was \$1.7 billion and \$1.6 billion at December 31, 2019 and 2018, respectively, and is included in accrued expenses and other liabilities on the consolidated statements of financial condition.

Protection Products Revenue

The Company earns revenue related to fees received for ancillary products and services, including payment protection and identity theft protection services, to its credit card customers. A portion of this revenue comprises amounts earned for arranging for the delivery of products offered by third-party service providers. The amount of revenue recorded is generally based on either a percentage of a customer's outstanding balance or a flat fee, in either case assessed monthly, and is recognized as earned. These contracts are month-to-month arrangements that are cancellable at any time. The Company recognizes each monthly fee in the period to which the service or coverage relates.

Transaction Processing Revenue

Transaction processing revenue represents switch fees charged to financial institutions and merchants under network participation agreements for processing ATM, debit and point-of-sale transactions over the PULSE network, as well as various participation and membership fees. Network participation agreements generally renew automatically and do not have fixed durations, although the Company does enter into fixed-term pricing or incentive arrangements with certain network participants. The impact of such incentives is not material to the Company's consolidated statements of income. Similar to discount and interchange fees, switch fees are contractually defined per-transaction fee amounts and are assessed and recognized as revenue at the time each transaction is captured for settlement. These fees are typically collected by the Company as part of the process of settling transactions with network participants. Membership and other participation fees are recognized over the periods to which each fee relates.

Other Income

Other income includes sales-based royalty revenues earned by Diners Club, merchant fees, certain payments from merchants related to reward programs, revenues from network partners and other miscellaneous revenue items. Sales-based royalty revenues are recognized as the related sales are reported by Diners franchisees. All remaining items of other income are recognized as the related performance obligations are satisfied.

Future Revenue Associated with Customer Contracts

For contracts under which the Company processes payment card transactions, the Company has the right to assess fees for services performed and to collect those fees through the settlement process. The Company generates essentially all of its discount and interchange revenue and transaction processing revenue, as well as some revenue reported as other income, through such contracts. There is no specified quantity of service promised in these contracts as the number of payment transactions is dependent upon cardholder behavior, which is outside the control of the Company and its network customers (i.e., merchants, acquirers, issuers and other network participants). As noted above, these contracts are typically without fixed durations and renew automatically. For these reasons, the Company does not make or disclose an estimate of revenue associated with performance obligations attributable to the remaining terms of these contracts. Future revenue associated with the Company's sales-based royalty revenues earned from Diners Club licensees is similarly variable and open-ended, and therefore the Company does not make or disclose an estimate of royalties associated with performance obligations attributable to the remaining terms of the licensing and royalty arrangements. Because of the nature of the services and the manner of collection associated with the majority of the Company's revenue from contracts with customers, material receivables or deferred revenues are not generated.

Incentive Payments

The Company makes certain incentive payments under contractual arrangements with financial institutions, Diners Club licensees, merchants, acquirers and certain other customers. These payments are generally classified as contra-revenue unless a distinct good or service is received by the Company in consideration for the payment and the fair value of the good or service can be reasonably estimated. If no such good or service is identified, then the entire payment is classified as contra-revenue and included in the consolidated statements of income in the line item where the related revenues are recorded. If the payment gives rise to an asset because it is expected to directly or indirectly contribute to future net cash inflows, it is deferred and recognized over the expected benefit period. The unamortized portion of the deferred incentive payments included in other assets on the consolidated statements of financial condition was \$24 million and \$23 million at December 31, 2019 and 2018, respectively.

3. Investments

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

	December 31,	
	2019	2018
U.S. Treasury securities ⁽¹⁾	\$ 9,906	\$ 2,586
Residential mortgage-backed securities - Agency ⁽²⁾	689	784
Total investment securities	\$ 10,595	\$ 3,370

(1) Includes \$121 million and \$42 million of U.S. Treasury securities pledged as swap collateral as of December 31, 2019 and 2018, respectively.

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

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 December 31, 2019				
Available-for-Sale Investment Securities⁽¹⁾				
U.S. Treasury securities	\$ 9,759	\$ 155	\$ (8)	\$ 9,906
Residential mortgage-backed securities - Agency	414	3	—	417
Total available-for-sale investment securities	\$ 10,173	\$ 158	\$ (8)	\$ 10,323
Held-to-Maturity Investment Securities⁽²⁾				
Residential mortgage-backed securities - Agency ⁽³⁾	\$ 272	\$ 3	\$ (1)	\$ 274
Total held-to-maturity investment securities	\$ 272	\$ 3	\$ (1)	\$ 274
At December 31, 2018				
Available-for-Sale Investment Securities⁽¹⁾				
U.S. Treasury securities	\$ 2,559	\$ 27	\$ —	\$ 2,586
Residential mortgage-backed securities - Agency	559	—	(12)	547
Total available-for-sale investment securities	\$ 3,118	\$ 27	\$ (12)	\$ 3,133
Held-to-Maturity Investment Securities⁽²⁾				
Residential mortgage-backed securities - Agency ⁽³⁾	\$ 237	\$ —	\$ (4)	\$ 233
Total held-to-maturity investment securities	\$ 237	\$ —	\$ (4)	\$ 233

(1) Available-for-sale investment securities are reported at fair value.

(2) Held-to-maturity investment securities are reported at amortized cost.

(3) Amounts represent residential mortgage-backed securities that were classified as held-to-maturity as they were entered into as a part of the Company's community reinvestment initiatives.

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 December 31, 2019					
Available-for-Sale Investment Securities					
U.S. Treasury securities	11	\$ 1,402	\$ (8)	\$ —	\$ —
Held-to-Maturity Investment Securities					
Residential mortgage-backed securities - Agency	58	\$ 64	\$ —	\$ 19	\$ (1)
At December 31, 2018					
Available-for-Sale Investment Securities					
Residential mortgage-backed securities - Agency	31	\$ 110	\$ (1)	\$ 437	\$ (11)
Held-to-Maturity Investment Securities					
Residential mortgage-backed securities - Agency	90	\$ 101	\$ (1)	\$ 83	\$ (3)

There were no losses related to other-than-temporary impairments and no proceeds from sales or recognized gains and losses on available-for-sale securities during the years ended December 31, 2019, 2018 and 2017. See Note 13: Accumulated Other Comprehensive Income for unrealized gains and losses on available-for-sale securities during the years ended December 31, 2019, 2018 and 2017.

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

At December 31, 2019	One Year or Less	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years	Total
Available-for-Sale Investment Securities—Amortized Cost					
U.S. Treasury securities	\$ 870	\$ 8,369	\$ 520	\$ —	\$ 9,759
Residential mortgage-backed securities - Agency ⁽¹⁾	—	85	329	—	414
Total available-for-sale investment securities	<u>\$ 870</u>	<u>\$ 8,454</u>	<u>\$ 849</u>	<u>\$ —</u>	<u>\$ 10,173</u>
Held-to-Maturity Investment Securities—Amortized Cost					
Residential mortgage-backed securities - Agency ⁽¹⁾	\$ —	\$ —	\$ —	\$ 272	\$ 272
Total held-to-maturity investment securities	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 272</u>	<u>\$ 272</u>
Available-for-Sale Investment Securities—Fair Values					
U.S. Treasury securities	\$ 875	\$ 8,511	\$ 520	\$ —	\$ 9,906
Residential mortgage-backed securities - Agency ⁽¹⁾	—	86	331	—	417
Total available-for-sale investment securities	<u>\$ 875</u>	<u>\$ 8,597</u>	<u>\$ 851</u>	<u>\$ —</u>	<u>\$ 10,323</u>
Held-to-Maturity Investment Securities—Fair Values					
Residential mortgage-backed securities - Agency ⁽¹⁾	\$ —	\$ —	\$ —	\$ 274	\$ 274
Total held-to-maturity investment securities	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 274</u>	<u>\$ 274</u>

(1) Maturities of residential mortgage-backed securities are reflective of the contractual maturities of the investment.

At December 31, 2019	One Year or Less	After One Year Through Five Years	After Five Years Through Ten Years	After Ten Years	Total
Available-for-Sale Investment Securities—Weighted-Average Yields⁽¹⁾					
U.S Treasury securities	2.63%	2.20%	1.70%	—%	2.21%
Residential mortgage-backed securities - Agency	—%	1.58%	2.07%	—%	1.97%
Total available-for-sale investment securities	2.63%	2.19%	1.84%	—%	2.20%
Held-to-Maturity Investment Securities—Weighted-Average Yields					
Residential mortgage-backed securities	—%	—%	—%	3.36%	3.36%
Total held-to-maturity investment securities	—%	—%	—%	3.36%	3.36%

(1) The weighted-average yield for available-for-sale investment securities is calculated based on the amortized cost.

Taxable interest on investment securities was \$179 million, \$40 million and \$27 million for the years ended December 31, 2019, 2018 and 2017, respectively. There was no tax exempt interest on investment securities for the years ended December 31, 2019, 2018 and 2017.

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 consolidated statements of financial condition. The portion of each investment's operating results allocable to the Company reduces the carrying value of the investments and is recorded in other expense within the consolidated statements of income. The Company further reduces the carrying value of the investments by recognizing any amounts that are in excess of future net tax benefits in other expense. 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 December 31, 2019 and 2018, the

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Company had outstanding investments in these entities of \$336 million and \$295 million, respectively, and related contingent liabilities of \$74 million and \$49 million, respectively. Of the above outstanding equity investments, the Company had \$298 million and \$271 million of investments related to affordable housing projects as of December 31, 2019 and 2018, respectively, which had \$59 million and \$30 million related contingent liabilities, respectively.

The Company holds non-controlling equity positions in several payments services entities. Most of these investments are not subject to equity method accounting because the Company does not have significant influence over the investee. The common or preferred equity securities that the Company hold typically do not have readily determinable fair values. As a result, the majority of these investments are carried at cost minus impairment, if any. As of December 31, 2019 and 2018, the carrying value of these investments, which is recorded within other assets, was \$42 million and \$40 million, respectively.

4. Loan Receivables

The Company has three loan portfolio segments: credit card loans, other loans and PCI loans.

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

	December 31,	
	2019	2018
Credit card loans ⁽¹⁾	\$ 77,181	\$ 72,876
Other loans		
Personal loans	7,687	7,454
Private student loans	8,402	7,728
Other	1,373	817
Total other loans	17,462	15,999
PCI loans ⁽²⁾	1,251	1,637
Total loan receivables	95,894	90,512
Allowance for loan losses	(3,383)	(3,041)
Net loan receivables	\$ 92,511	\$ 87,471

(1) Amounts include carrying values of \$18.9 billion and \$22.0 billion underlying investors' interest in trust debt at December 31, 2019 and 2018, respectively, and \$12.7 billion and \$11.1 billion in seller's interest at December 31, 2019 and 2018, respectively. See Note 5: Credit Card and Student Loan Securitization Activities for additional information.

(2) Amounts include carrying values of \$292 million and \$363 million in loans pledged as collateral against the note issued from a student loan securitization trust at December 31, 2019 and 2018, respectively. See Note 5: Credit Card and Student Loan Securitization Activities for additional information.

Credit Quality Indicators

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

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 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 December 31, 2019					
Credit card loans ⁽²⁾	\$ 999	\$ 1,020	\$ 2,019	\$ 940	\$ 237
Other loans					
Personal loans ⁽³⁾	74	31	105	29	12
Private student loans (excluding PCI) ⁽⁴⁾	109	36	145	35	11
Other	5	2	7	—	6
Total other loans (excluding PCI)	188	69	257	64	29
Total loan receivables (excluding PCI)	\$ 1,187	\$ 1,089	\$ 2,276	\$ 1,004	\$ 266
At December 31, 2018					
Credit card loans ⁽²⁾	\$ 885	\$ 887	\$ 1,772	\$ 781	\$ 266
Other loans					
Personal loans ⁽³⁾	84	35	119	33	11
Private student loans (excluding PCI) ⁽⁴⁾	117	38	155	37	8
Other	2	1	3	—	17
Total other loans (excluding PCI)	203	74	277	70	36
Total loan receivables (excluding PCI)	\$ 1,088	\$ 961	\$ 2,049	\$ 851	\$ 302

(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 \$45 million, \$41 million and \$35 million for the years ended December 31, 2019, 2018 and 2017, 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 \$175 million and \$116 million of loans accounted for as TDRs at December 31, 2019 and 2018, respectively.

(3) Personal loans that are 90 or more days delinquent and accruing interest include \$7 million and \$5 million of loans accounted for as TDRs at December 31, 2019 and 2018, respectively.

(4) Private student loans that are 90 or more days delinquent and accruing interest include \$10 million and \$7 million of loans accounted for as TDRs at December 31, 2019 and 2018, respectively.

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

	For the Years Ended December 31,					
	2019		2018		2017	
	Net Charge-offs	Net Charge-off Rate ⁽¹⁾	Net Charge-offs	Net Charge-off Rate ⁽¹⁾	Net Charge-offs	Net Charge-off Rate ⁽¹⁾
Credit card loans	\$ 2,494	3.43%	\$ 2,213	3.26%	\$ 1,802	2.91%
Other loans						
Personal loans	322	4.28%	308	4.15%	231	3.30%
Private student loans (excluding PCI)	69	0.85%	85	1.14%	83	1.21%
Other	1	0.02%	6	0.98%	3	0.75%
Total other loans	392	2.34%	399	2.58%	317	2.24%
Net charge-offs (excluding PCI)	\$ 2,886	3.23%	\$ 2,612	3.13%	\$ 2,119	2.78%
Net charge-offs (including PCI)	\$ 2,886	3.17%	\$ 2,612	3.06%	\$ 2,119	2.70%

(1) Net charge-off rate represents net charge-off dollars (annualized) divided by average loans for the reporting period.

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 portion of delinquent accounts have FICO scores below 660.

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

	Credit Risk Profile by FICO Score	
	660 and Above	Less than 660 or No Score
At December 31, 2019		
Credit card loans	80%	20%
Personal loans	94%	6%
Private student loans (excluding PCI) ⁽¹⁾	94%	6%
At December 31, 2018		
Credit card loans	81%	19%
Personal loans	94%	6%
Private student loans (excluding PCI) ⁽¹⁾	94%	6%

(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 December 31, 2019 and 2018, there were \$46 million and \$37 million, respectively, of private student loans, including those classified as PCI, in forbearance, representing 0.8% and 0.7%, respectively, of total student loans in repayment and forbearance.

Allowance for Loan Losses

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

	For the Year Ended December 31, 2019				
	Credit Card	Personal Loans	Student Loans ⁽¹⁾	Other	Total
Balance at beginning of period	\$ 2,528	\$ 338	\$ 169	\$ 6	\$ 3,041
Additions					
Provision for loan losses	2,849	332	51	(1)	3,231
Deductions					
Charge-offs	(3,165)	(369)	(82)	(1)	(3,617)
Recoveries	671	47	13	—	731
Net charge-offs	(2,494)	(322)	(69)	(1)	(2,886)
Other ⁽²⁾	—	—	(3)	—	(3)
Balance at end of period	<u>\$ 2,883</u>	<u>\$ 348</u>	<u>\$ 148</u>	<u>\$ 4</u>	<u>\$ 3,383</u>

	For the Year Ended December 31, 2018				
	Credit Card	Personal Loans	Student Loans ⁽¹⁾	Other	Total
Balance at beginning of period	\$ 2,147	\$ 301	\$ 162	\$ 11	\$ 2,621
Additions					
Provision for loan losses	2,594	345	95	1	3,035
Deductions					
Charge-offs	(2,734)	(345)	(97)	(6)	(3,182)
Recoveries	521	37	12	—	570
Net charge-offs	(2,213)	(308)	(85)	(6)	(2,612)
Other ⁽²⁾	—	—	(3)	—	(3)
Balance at end of period	<u>\$ 2,528</u>	<u>\$ 338</u>	<u>\$ 169</u>	<u>\$ 6</u>	<u>\$ 3,041</u>

	For the Year Ended December 31, 2017				
	Credit Card	Personal Loans	Student Loans ⁽¹⁾	Other	Total
Balance at beginning of period	\$ 1,790	\$ 200	\$ 158	\$ 19	\$ 2,167
Additions					
Provision for loan losses	2,159	332	93	(5)	2,579
Deductions					
Charge-offs	(2,263)	(258)	(94)	(3)	(2,618)
Recoveries	461	27	11	—	499
Net charge-offs	(1,802)	(231)	(83)	(3)	(2,119)
Other ⁽²⁾	—	—	(6)	—	(6)
Balance at end of period	<u>\$ 2,147</u>	<u>\$ 301</u>	<u>\$ 162</u>	<u>\$ 11</u>	<u>\$ 2,621</u>

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

(2) Net change in reserves on PCI pools having no remaining non-accretable difference.

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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 Years Ended December 31,		
	2019	2018	2017
Interest and fees accrued subsequently charged off, net of recoveries (recorded as a reduction of interest income)	\$ 515	\$ 442	\$ 353
Fees accrued subsequently charged off, net of recoveries (recorded as a reduction to other income)	\$ 123	\$ 109	\$ 89

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 ⁽¹⁾	Other Loans	Total
At December 31, 2019					
Allowance for loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	\$ 2,283	\$ 281	\$ 95	\$ 4	\$ 2,663
Evaluated for impairment in accordance with ASC 310-10-35 ⁽²⁾⁽³⁾	600	67	31	—	698
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	22	—	22
Total allowance for loan losses	\$ 2,883	\$ 348	\$ 148	\$ 4	\$ 3,383
Recorded investment in loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	\$ 73,819	\$ 7,479	\$ 8,133	\$ 1,330	\$ 90,761
Evaluated for impairment in accordance with ASC 310-10-35 ⁽²⁾⁽³⁾	3,362	208	269	43	3,882
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	1,251	—	1,251
Total recorded investment	\$ 77,181	\$ 7,687	\$ 9,653	\$ 1,373	\$ 95,894
At December 31, 2018					
Allowance for loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	\$ 2,229	\$ 292	\$ 121	\$ 4	\$ 2,646
Evaluated for impairment in accordance with ASC 310-10-35 ⁽²⁾⁽³⁾	299	46	23	2	370
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	25	—	25
Total allowance for loan losses	\$ 2,528	\$ 338	\$ 169	\$ 6	\$ 3,041
Recorded investment in loans evaluated for impairment as					
Collectively evaluated for impairment in accordance with ASC 450-20	\$ 70,628	\$ 7,302	\$ 7,546	\$ 761	\$ 86,237
Evaluated for impairment in accordance with ASC 310-10-35 ⁽²⁾⁽³⁾	2,248	152	182	56	2,638
Acquired with deteriorated credit quality, evaluated in accordance with ASC 310-30	—	—	1,637	—	1,637
Total recorded investment	\$ 72,876	\$ 7,454	\$ 9,365	\$ 817	\$ 90,512

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

(2) Loan receivables evaluated for impairment in accordance with 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 TDRs. Other loans are individually evaluated for impairment and generally do not represent TDRs.

(3) The unpaid principal balance of credit card loans was \$3.0 billion and \$2.0 billion at December 31, 2019 and 2018, respectively. All loans accounted for as TDRs have a related allowance for loan losses.

Troubled Debt Restructurings

The Company has internal loan modification programs that provide relief to credit card, personal loan and student loan borrowers who may be experiencing financial hardship. The Company continually evaluates new programs to determine which of them meet the definition of a TDR. 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, result in the loans being classified as individually impaired. In addition, loans that defaulted or graduated from modification programs or forbearance continue to be classified as individually impaired.

For credit card customers, the Company offers both temporary and permanent hardship programs. The temporary hardship programs consist of an interest rate reduction and in some cases a reduced minimum payment, both lasting for a period no longer than 12 months. Charging privileges on these loans are generally suspended while in the program and if certain criteria are met, may be reinstated following completion of the program. Balances remaining at the end of the program as well as any new charges continue to be included in the balance of TDRs, contributing to the growth in total TDRs disclosed. In addition to helping customers with their credit needs, these programs are designed to maximize the collection cash flows and ultimately the Company's profitability.

The permanent modification program involves closing the account, 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 permanent loan modifications for customers who request financial assistance through external sources, such as a consumer credit counseling agency program. 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. These loans remain in the population of TDRs until they are paid off or charged off.

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 programs involve 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 permanent 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 TDRs.

At December 31, 2019, there was \$5.6 billion of private student loans in repayment, which includes both PCI and non-PCI loans. To assist student loan borrowers who are experiencing temporary financial difficulties but are willing to resume making payments, the Company may offer hardship forbearance or programs that include payment deferral, temporary payment reduction, temporary interest rate reduction or extended terms. A non-PCI modified loan typically meets the definition of a TDR based on the cumulative length of the concession period and an evaluation of the credit quality of the borrower based on FICO scores.

Borrower performance after using payment programs or forbearance is monitored and the Company believes the programs are useful in assisting customers experiencing financial difficulties and help to prevent defaults. The Company plans to continue to use payment programs and forbearance as a means to provide relief to customers experiencing temporary financial difficulties and, as a result, expects to have additional loans classified as TDRs in the future.

Additional information about modified loans classified as TDRs 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 Year Ended December 31, 2019			
Credit card loans ⁽³⁾	\$ 2,821	\$ 347	\$ 202
Personal loans	\$ 180	\$ 18	\$ 10
Private student loans	\$ 226	\$ 18	\$ 1
For the Year Ended December 31, 2018			
Credit card loans ⁽³⁾	\$ 1,737	\$ 180	\$ 137
Personal loans	\$ 130	\$ 14	\$ 6
Private student loans	\$ 158	\$ 13	\$ —
For the Year Ended December 31, 2017			
Credit card loans ⁽³⁾	\$ 1,159	\$ 107	\$ 86
Personal loans	\$ 94	\$ 10	\$ 4
Private student loans	\$ 113	\$ 8	\$ —

- (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 additional 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 loans and the average interest rate earned on loans in the modification programs to the average loans in the modification programs.
- (3) Includes credit card loans that were modified in TDRs, but are no longer enrolled in a TDR program due to noncompliance with the terms of the modification or due to successful completion of a program after which charging privileges may be reinstated based on customer-level evaluation. The average balance of credit card loans that were no longer enrolled in a TDR program was \$916 million, \$430 million and \$339 million, respectively, for the years ended December 31, 2019, 2018 and 2017.

In order to evaluate the primary financial effects that resulted from credit card loans entering into a loan modification program during the years ended December 31, 2019, 2018 and 2017, the Company quantified the amount by which interest and fees were reduced during the periods. During the years ended December 31, 2019, 2018 and 2017, the Company forgave approximately \$73 million, \$48 million and \$40 million, respectively, of interest and fees as a result of accounts entering into a credit card loan modification program.

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

	For the Years Ended December 31,					
	2019		2018		2017	
	Number of Accounts	Balances	Number of Accounts	Balances	Number of Accounts	Balances
Accounts that entered a loan modification program during the period						
Credit card loans	368,009	\$ 2,364	268,817	\$ 1,713	133,139	\$ 776
Personal loans	10,945	\$ 147	8,260	\$ 111	6,567	\$ 82
Private student loans	6,742	\$ 124	4,057	\$ 74	3,942	\$ 69

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

	For the Years Ended December 31,					
	2019		2018		2017	
	Number of Accounts	Aggregated Outstanding Balances Upon Default	Number of Accounts	Aggregated Outstanding Balances Upon Default	Number of Accounts	Aggregated Outstanding Balances Upon Default
Troubled debt restructurings that subsequently defaulted						
Credit card loans ⁽¹⁾⁽²⁾	71,326	\$ 410	42,659	\$ 239	34,210	\$ 183
Personal loans ⁽²⁾	4,152	\$ 59	2,955	\$ 40	1,915	\$ 25
Private student loans ⁽³⁾	1,406	\$ 27	1,041	\$ 19	939	\$ 16

(1) 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) For credit card loans and personal loans, a customer defaults from a modification program after two consecutive missed payments. The outstanding balance upon default is generally the loan balance at the end of the month prior to default.

(3) For student loans, defaults have been defined as loans that are 60 or more days delinquent. The outstanding balance upon default is generally the loan balance at the end of the month prior to default.

Of the account balances that defaulted as shown above for the years ended December 31, 2019, 2018 and 2017, approximately 38%, 36% and 37%, respectively, of the total balances were charged off at the end of the month in which they defaulted from a loan modification program. 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 as part of the Company's acquisition of The Student Loan Corporation (“SLC”) as well as the additional acquired private student loan portfolio comprise the Company's only PCI loans at December 31, 2019 and 2018. Total PCI student loans had an outstanding balance of \$1.3 billion and \$1.7 billion, including accrued interest, and a related carrying amount of \$1.3 billion and \$1.6 billion, as of December 31, 2019 and 2018, respectively.

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

	For the Years Ended December 31,		
	2019	2018	2017
Balance at beginning of period	\$ 548	\$ 669	\$ 796
Accretion into interest income	(119)	(139)	(159)
Other changes in expected cash flows	23	18	32
Balance at end of period	<u>\$ 452</u>	<u>\$ 548</u>	<u>\$ 669</u>

Periodically, the Company updates the estimate of cash flows expected to be collected based on management's latest expectations of future net credit losses, borrower prepayments and certain other assumptions that affect cash flows. No provision expense was recorded during the years ended December 31, 2019, 2018 and 2017. The allowance for PCI loan losses at December 31, 2019 and 2018 was \$22 million and \$25 million, respectively. For the years ended December 31, 2019, 2018 and 2017, the increase in accretable yield was primarily due to changes in rates on variable-rate loans. Changes to accretable yield are recognized prospectively as an adjustment to yield over the remaining life of the pools.

At December 31, 2019, 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 2.92% and 0.80%, respectively. At December 31, 2018, the 30 or more days delinquency and 90 or more days delinquency rates on PCI student loans (which include loans not yet in

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repayment) were 2.93% and 0.78%, respectively. These rates include private student loans that are greater than 120 days delinquent that are covered by an indemnification agreement or insurance arrangements through which the Company expects to recover a substantial portion of the loan. The net charge-off rate on PCI student loans for the years ended December 31, 2019, 2018 and 2017 was 0.47%, 0.63% and 0.71%, respectively.

Geographical Distribution of Loans

The Company originates credit card loans throughout the United States. The geographic distribution of the Company's credit card loan receivables was as follows (dollars in millions):

	December 31,			
	2019		2018	
	\$	%	\$	%
California	\$ 7,110	9.2%	\$ 6,620	9.1%
Texas	6,543	8.5	6,155	8.4
New York	5,335	6.9	5,040	6.9
Florida	5,176	6.7	4,815	6.6
Illinois	4,084	5.3	3,878	5.3
Pennsylvania	3,873	5.0	3,712	5.1
Ohio	3,207	4.2	3,039	4.2
New Jersey	2,807	3.6	2,661	3.7
Georgia	2,325	3.0	2,160	3.0
Michigan	2,165	2.8	2,042	2.8
Other	34,556	44.8	32,754	44.9
Total credit card loans	<u>\$ 77,181</u>	<u>100%</u>	<u>\$ 72,876</u>	<u>100%</u>

The Company originates personal loans, student loans and other loans, and has PCI loans throughout the United States. The geographic distribution of personal, student, other and PCI loan receivables was as follows (dollars in millions):

	December 31,			
	2019		2018	
	\$	%	\$	%
New York	\$ 1,859	9.9%	\$ 1,834	10.4%
California	1,764	9.4	1,656	9.4
Pennsylvania	1,275	6.8	1,221	6.9
Illinois	1,157	6.2	1,098	6.2
Texas	1,151	6.2	1,071	6.1
New Jersey	980	5.2	925	5.2
Florida	930	5.0	838	4.8
Ohio	739	4.0	698	4.0
Massachusetts	594	3.2	584	3.3
Michigan	585	3.1	560	3.2
Other	7,679	41.0	7,151	40.5
Total other loans (including PCI loans)	<u>\$ 18,713</u>	<u>100%</u>	<u>\$ 17,636</u>	<u>100%</u>

5. Credit Card and Student Loan Securitization Activities

The Company's securitizations are accounted for as secured borrowings and the related trusts are treated as consolidated subsidiaries of the Company. For a description of the Company's principles of consolidation with respect to VIEs, see Note 1: Background and Basis of Presentation.

Credit Card Securitization Activities

The Company accesses the term asset securitization market through DCMT and DCENT. Credit card loan receivables are transferred into DCMT and beneficial interests in DCMT are transferred into DCENT. DCENT issues debt securities to investors that are reported in long-term borrowings.

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 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 subordinated classes are held by wholly-owned subsidiaries of Discover Bank. The Company is exposed to credit-related risk of loss associated with trust assets as of the balance sheet date through the retention of these subordinated interests. The estimated probable incurred loss is included in the allowance for loan losses estimate.

The Company's retained interests in the assets of the trusts, consisting of investments in DCENT notes held by subsidiaries of Discover Bank, constitute intercompany positions, which are eliminated in the preparation of the Company's 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, the amounts of which are reported in restricted cash. 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. 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 carrying values of these restricted assets, which are presented on the Company's consolidated statements of financial condition as relating to securitization activities, are shown in the following table (dollars in millions):

	December 31,	
	2019	2018
Restricted cash	\$ 28	\$ 1,834
Investors' interests held by third-party investors	14,100	16,800
Investors' interests held by wholly-owned subsidiaries of Discover Bank	4,796	5,211
Seller's interest	12,652	11,050
Loan receivables ⁽¹⁾	31,548	33,061
Allowance for loan losses allocated to securitized loan receivables ⁽¹⁾	(1,179)	(1,150)
Net loan receivables	30,369	31,911
Other	5	7
Carrying value of assets of consolidated variable interest entities	\$ 30,402	\$ 33,752

(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 in the securities, there are certain features or triggering events that could cause an early amortization of the debt securities, including triggers related to the impact of the performance of the trust receivables on the availability and adequacy of cash flows to meet contractual requirements. As of December 31, 2019, no economic or other early amortization events have occurred.

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

Student loan trust receivables are recorded in PCI loans and the related debt issued by the trusts is reported in long-term borrowings. The assets of the trusts 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. With the exception of the trusts' restricted assets, the trusts and investors have no recourse to the Company's other assets or the Company's general credit for a shortage in cash flows.

Securities issued to investors are outstanding from only one of the two remaining student loan securitization trusts. 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 trust until cash is released in accordance with the trust indenture agreement. Similar to the credit card securitizations, the Company continues to own and service the accounts that generate the student loan receivables held by the trust and receives servicing fees from the trust based on a percentage of the principal balance outstanding. Although the servicing fee income offsets the fee expense related to the trust 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 the trust arrangement, the Company has the option, but not the obligation, to provide financial support to the trust, but has never provided such support. A substantial portion of the credit risk associated with the securitized loans has been transferred to a third party under an indemnification arrangement.

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

	December 31,	
	2019	2018
Restricted cash	\$ 12	\$ 12
Student loan receivables	292	363
Carrying value of assets of consolidated variable interest entities	<u>\$ 304</u>	<u>\$ 375</u>

6. Premises and Equipment

A summary of premises and equipment, net is as follows (dollars in millions):

	December 31,	
	2019	2018
Land	\$ 42	\$ 42
Buildings and improvements	693	671
Furniture, fixtures and equipment	1,082	989
Software	851	696
Premises and equipment	<u>2,668</u>	<u>2,398</u>
Less: accumulated depreciation	(1,276)	(1,193)
Less: accumulated amortization of software	(335)	(269)
Premises and equipment, net	<u>\$ 1,057</u>	<u>\$ 936</u>

Depreciation expense was \$84 million, \$75 million and \$76 million for the years ended December 31, 2019, 2018 and 2017, respectively. Amortization expense on capitalized software was \$80 million, \$67 million and \$52 million for the years ended December 31, 2019, 2018 and 2017, respectively.

7. Goodwill and Intangible Assets

Goodwill

As of December 31, 2019 and 2018, the Company had goodwill of \$255 million related to PULSE, part of the Payment Services segment. The Company conducted its annual goodwill impairment test as of October 1, 2019 and 2018 and no impairment charges were identified.

Intangible Assets

The Company's amortizable intangible assets consisting of customer relationships and trade names resulted from various acquisitions and are primarily included in the Payment Services segment.

Non-amortizable intangible assets consist primarily of trade name intangibles and international transaction processing rights included in the Payment Services segment. The Company conducted its annual impairment test of intangible assets as of October 1, 2019 and 2018 and no material impairment charges were identified.

The following table summarizes the Company's intangible assets (dollars in millions):

	December 31,					
	2019			2018		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Amortizable intangible assets						
Customer relationships	\$ 69	\$ 68	\$ 1	\$ 69	\$ 67	\$ 2
Trade name and other	8	5	3	8	4	4
Total amortizable intangible assets	77	73	4	77	71	6
Non-amortizable intangible assets						
Trade names	128	—	128	132	—	132
International transaction processing rights	23	—	23	23	—	23
Total non-amortizable intangible assets	151	—	151	155	—	155
Total intangible assets	\$ 228	\$ 73	\$ 155	\$ 232	\$ 71	\$ 161

Amortization expense related to the Company's intangible assets was not material for the years ended December 31, 2019, 2018 and 2017 and the expected amortization expense for the next five years based on intangible assets at the end of the current period is not material, either individually or in the aggregate.

8. 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 online savings accounts, certificates of deposit, money market accounts, IRA certificates of deposit and checking accounts, while brokered deposits include certificates of deposit and sweep accounts.

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

	December 31,	
	2019	2018
Certificates of deposit in amounts less than \$100,000	\$ 25,113	\$ 27,947
Certificates of deposit in amounts \$100,000 or greater ⁽¹⁾	9,268	6,841
Savings deposits, including money market deposit accounts	37,574	32,296
Total interest-bearing deposits	<u>\$ 71,955</u>	<u>\$ 67,084</u>

(1) Includes \$2.6 billion and \$1.7 billion in certificates of deposit equal to or greater than \$250,000, the Federal Deposit Insurance Corporation (“FDIC”) insurance limit, as of December 31, 2019 and 2018, respectively.

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

	December 31, 2019
Three months or less	\$ 1,576
Over three months through six months	1,516
Over six months through twelve months	3,429
Over twelve months	2,747
Total	<u>\$ 9,268</u>

The following table summarizes certificates of deposit maturing over each of the next five years and thereafter (dollars in millions):

	December 31, 2019
2020	\$ 18,976
2021	6,980
2022	3,292
2023	1,913
2024	1,309
Thereafter	1,911
Total	<u>\$ 34,381</u>

9. Long-Term Borrowings

Long-term borrowings consist of borrowings 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):

	December 31, 2019			December 31, 2018	
	Maturity	Interest Rate	Weighted-Average Interest Rate	Outstanding Amount	Outstanding Amount
Securitized Debt					
Fixed-rate asset-backed securities ⁽¹⁾	2020-2024	1.85%-3.32%	2.50%	\$ 8,609	\$ 10,657
Floating-rate asset-backed securities ⁽²⁾⁽³⁾	2020-2024	1.97%-2.46%	2.15%	5,515	6,063
Total Discover Card Master Trust I and Discover Card Execution Note Trust				14,124	16,720
Floating-rate asset-backed security ⁽⁴⁾⁽⁵⁾	2031	5.75%	5.75%	160	197
Total student loan securitization trust				160	197
Total long-term borrowings - owed to securitization investors				14,284	16,917
Discover Financial Services (Parent Company)					
Fixed-rate senior notes	2022-2027	3.75%-5.20%	4.16%	3,296	2,743
Fixed-rate retail notes	2021-2031	2.85%-4.60%	3.73%	340	346
Discover Bank					
Fixed-rate senior bank notes ⁽¹⁾	2020-2028	2.45%-4.65%	3.55%	6,785	6,027
Fixed-rate subordinated bank notes ⁽¹⁾	2020-2028	4.68%-7.00%	5.84%	996	1,195
Total long-term borrowings				\$ 25,701	\$ 27,228

- (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") or Overnight Index Swap ("OIS") Rate. Use of these interest rate swaps impacts carrying value of the debt. See Note 21: 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 + 23 to 60 basis points and Commercial paper rate + 55 basis points as of December 31, 2019.
- (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 21: Derivatives and Hedging Activities.
- (4) The student loan securitization trust floating-rate asset-backed security includes an issuance with the following interest rate term: Prime rate + 100 basis points as of December 31, 2019.
- (5) Repayment of this debt is dependent upon the timing of principal and interest payments on the underlying student loans. The date shown represents final maturity date.

The following table summarizes long-term borrowings maturing over each of the next five years and thereafter (dollars in millions):

	Amount
2020	\$ 5,247
2021	4,210
2022	5,119
2023	3,319
2024	2,565
Thereafter	5,241
Total	\$ 25,701

The Company has access to committed borrowing capacity through private securitizations to support the funding of its credit card loan receivables. As of December 31, 2019, the total commitment of secured credit facilities through

private providers was \$6.0 billion, \$500 million of which was drawn at December 31, 2019. 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 calendar years 2021 through 2022. 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.

10. Stock-Based Compensation Plans

The Company has two stock-based compensation plans: the Discover Financial Services Omnibus Incentive Plan (“Omnibus Plan”) and the Discover Financial Services Directors’ Compensation Plan (“Directors’ Compensation Plan”).

Omnibus Plan

The Omnibus Plan, which is stockholder approved, provides for the award of stock options, stock appreciation rights, restricted stock, restricted stock units (“RSUs”), performance stock units (“PSUs”) and other stock-based and/or cash awards (collectively, “awards”). Currently, the Company does not have any stock options, stock appreciation rights or restricted stock outstanding. The total number of shares that may be granted is 45 million shares, subject to adjustments for certain transactions as described in the Omnibus Plan document. Shares granted under the Omnibus Plan may be the following: (i) authorized but unissued shares and (ii) treasury shares that the Company acquires in the open market, in private transactions or otherwise.

Directors’ Compensation Plan

The Directors’ Compensation Plan, which is stockholder approved, permits the grant of RSUs to non-employee directors. Under the Directors’ Compensation Plan, the Company may issue awards of up to a total of 1,000,000 shares of common stock to non-employee directors. Shares of stock that are issuable pursuant to the awards granted under the Directors’ Compensation Plan may be authorized but unissued shares, treasury shares or shares that the Company acquires in the open market. Annual awards for eligible directors are calculated by dividing \$150,000 by the fair market value of a share of stock on the date of grant and are subject to a restriction period whereby 100% of such units shall vest in full on the earlier of the one year anniversary of the date of grant or immediately prior to the first annual meeting of shareholders following the date of grant. RSUs include the right to receive dividend equivalents in the same amount and at the same time as dividends paid to all Company common shareholders.

Stock-Based Compensation

The following table details the compensation cost, net of forfeitures (dollars in millions):

	For the Years Ended December 31,		
	2019	2018	2017
RSUs	\$ 49	\$ 49	\$ 44
PSUs	20	32	31
Total stock-based compensation expense	<u>\$ 69</u>	<u>\$ 81</u>	<u>\$ 75</u>
Income tax benefit	\$ 12	\$ 15	\$ 28

RSUs

The following table sets forth the activity related to vested and unvested RSUs:

	Number of Units	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
RSUs at December 31, 2018	2,606,494		\$ 154
Granted	878,380		
Conversions to common stock	(1,230,886)		
Forfeited	(105,012)		
RSUs at December 31, 2019	<u>2,148,976</u>	0.91	\$ 182
Vested and convertible RSUs at December 31, 2019	<u>776,484</u>	—	\$ 66

The following table sets forth the activity related to unvested RSUs:

	Number of Units	Weighted-Average Grant-Date Fair Value
Unvested RSUs at December 31, 2018⁽¹⁾	1,041,158	\$ 68.16
Granted	878,380	\$ 73.52
Vested	(709,964)	\$ 67.49
Forfeited	(105,012)	\$ 73.67
Unvested RSUs at December 31, 2019⁽¹⁾	<u>1,104,562</u>	\$ 72.33

(1) Unvested RSUs represent awards where recipients have yet to satisfy either explicit vesting terms or retirement-eligibility requirements.

Compensation cost associated with RSUs is determined based on the number of units granted and the fair value on the date of grant. The fair value is amortized on a straight-line basis, net of estimated forfeitures over the requisite service period for each separately vesting tranche of the award. The requisite service period is generally the vesting period.

The following table summarizes the total intrinsic value of the RSUs converted to common stock and the total grant-date fair value of RSUs vested (dollars in millions, except weighted-average grant-date fair value amounts):

	For the Years Ended December 31,		
	2019	2018	2017
Intrinsic value of RSUs converted to common stock	\$ 93	\$ 67	\$ 41
Grant-date fair value of RSUs vested	\$ 48	\$ 54	\$ 37
Weighted-average grant-date fair value of RSUs granted	\$ 73.52	\$ 77.53	\$ 70.62

As of December 31, 2019, there was \$29 million of total unrecognized compensation cost related to non-vested RSUs. The cost is expected to be recognized over a weighted-average period of 0.91 years.

RSUs provide for accelerated vesting if there is a change in control or upon certain terminations (as defined in the Omnibus Plan or the award certificate). RSUs include the right to receive dividend equivalents in the same amount and at the same time as dividends paid to all Company common shareholders.

PSUs

The following table sets forth the activity related to vested and unvested PSUs:

	Number of Units	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in millions)
PSUs at December 31, 2018 ⁽¹⁾	933,642	\$ 62.25		\$ 55
Granted	248,185	\$ 71.62		
Conversions to common stock	(441,370)	\$ 48.59		
Forfeited	(16,924)	\$ 72.59		
PSUs at December 31, 2019 ⁽¹⁾⁽²⁾⁽³⁾⁽⁴⁾	<u>723,533</u>	\$ 73.56	1.07	\$ 61

(1) All PSUs outstanding at December 31, 2019 and December 31, 2018 are unvested PSUs.

(2) Includes 243,100 PSUs granted in 2017 that are earned based on the Company's achievement of earnings per share ("EPS") during the three-year performance period which ends December 31, 2019 and are subject to the requisite service period which ended February 1, 2020.

(3) Includes 246,503 PSUs granted in 2018 that are earned based on the Company's achievement of EPS during the three-year performance period which ends December 31, 2020 and are subject to the requisite service period which ends February 1, 2021.

(4) Includes 233,930 PSUs granted in 2019 that may be earned based on the Company's achievement of EPS during the three-year performance period which ends December 31, 2021 and are subject to the requisite service period which ends February 1, 2022.

Compensation cost associated with PSUs is determined based on the number of instruments granted, the fair value on the date of grant and the performance factor. The fair value is amortized on a straight-line basis, net of estimated forfeitures, over the requisite service period. Each PSU outstanding at December 31, 2019 is a restricted stock instrument that is subject to additional conditions and constitutes a contingent and unsecured promise by the Company to pay up to 1.5 shares per unit of the Company's common stock on the conversion date for the PSU, contingent on the number of PSUs to be issued. PSUs have a performance period of three years and a vesting period of three years. The requisite service period of an award, having both performance and service conditions, is the longest of the explicit, implicit and derived service periods.

The following table summarizes the total intrinsic value of the PSUs converted to common stock and the total grant-date fair value of PSUs vested (dollars in millions, except weighted-average grant-date fair value amounts):

	For the Years Ended December 31,		
	2019	2018	2017
Intrinsic value of PSUs converted to common stock	\$ 33	\$ 30	\$ 27
Grant-date fair value of PSUs vested	\$ 21	\$ 17	\$ 18
Weighted-average grant-date fair value of PSUs granted	\$ 71.62	\$ 77.75	\$ 71.17

As of December 31, 2019, there was \$5 million of total unrecognized compensation cost related to non-vested PSUs. The cost is expected to be recognized over a weighted-average period of 1.0 year.

PSUs provide for accelerated vesting if there is a change in control or upon certain terminations (as defined in the Omnibus Plan or the award certificate). PSUs include the right to receive dividend equivalents, which will accumulate and pay out in cash if and when the underlying shares are issued.

11. Employee Benefit Plans

The Company sponsors the Discover Financial Services Pension Plan (the "Discover Pension Plan"), which is a non-contributory defined benefit plan that is qualified under Section 401(a) of the Internal Revenue Code, for eligible employees in the U.S. Effective December 31, 2008, the Discover Pension Plan was amended to discontinue the accrual of future benefits. The Company also sponsors the Discover Financial Services 401(k) Plan (the "Discover 401(k) Plan"), which is a defined contribution plan that is qualified under Section 401(a) of the Internal Revenue Code, for its eligible U.S. employees.

Discover Pension Plan

The Discover Pension Plan generally provides retirement benefits that are based on each participant's years of credited service prior to 2009 and on compensation specified in the Discover Pension Plan. The Company's policy is to fund at least the amounts sufficient to meet minimum funding requirements under the Employee Retirement Income Security Act of 1974, as amended.

Net Periodic Benefit Cost

Net periodic benefit cost expensed by the Company included the following components (dollars in millions):

	For the Years Ended December 31,		
	2019	2018	2017
Interest cost on projected benefit obligation	\$ 23	\$ 22	\$ 23
Expected return on plan assets	(29)	(26)	(25)
Net amortization	4	5	4
Net periodic benefit (income) cost	<u>\$ (2)</u>	<u>\$ 1</u>	<u>\$ 2</u>

Accumulated Other Comprehensive Income

Pretax amounts recognized in AOCI that have not yet been recognized as components of net periodic benefit cost consist of (dollars in millions):

	December 31, 2019
Prior service credit	\$ 1
Net loss	(294)
Total	<u>\$ (293)</u>

Benefit Obligations and Funded Status

The following table provides a reconciliation of the changes in the benefit obligation and fair value of plan assets as well as a summary of the Discover Pension Plan's funded status (dollars in millions):

	For the Years Ended December 31,	
	2019	2018
Reconciliation of benefit obligation		
Benefit obligation at beginning of year	\$ 550	\$ 603
Interest cost	23	22
Actuarial losses (gains)	98	(57)
Benefits paid	(21)	(18)
Benefit obligation at end of year	650	550
Reconciliation of fair value of plan assets		
Fair value of plan assets at beginning of year	455	424
Actual return on plan assets	91	(36)
Employer contributions	—	85
Benefits paid	(21)	(18)
Fair value of plan assets at end of year	525	455
Unfunded status (recorded in accrued expenses and other liabilities)	\$ (125)	\$ (95)

Actuarial losses and gains on the benefit obligation were primarily driven by changes in the discount rate for the years ended December 31, 2019 and 2018.

Assumptions

The following table presents the assumptions used to determine the benefit obligation:

	December 31,	
	2019	2018
Discount rate	3.30%	4.27%

The following table presents the assumptions used to determine net periodic benefit cost:

	For the Years Ended December 31,		
	2019	2018	2017
Discount rate	4.27%	3.68%	4.29%
Expected long-term rate of return on plan assets	6.15%	6.15%	6.50%

The expected long-term rate of return on plan assets was estimated by computing a weighted-average return of the underlying long-term expected returns on the different asset classes, based on the target asset allocations. Asset class return assumptions are created by integrating information on past capital market performance, current levels of key economic indicators and the market insights of investment professionals. Individual asset classes are analyzed as part of a larger system, acknowledging both the interaction between asset classes and the influence of larger macroeconomic variables such as inflation and economic growth on the entire structure of capital markets. Medium and long-term economic outlooks for the U.S. and other major industrial economies are forecast in order to understand the range of possible economic scenarios and evaluate their likelihood. Historical relationships between key economic variables and asset class performance patterns are analyzed using empirical models. Finally, comprehensive asset class performance projections are created by blending descriptive asset class characteristics with capital market insight and

the initial economic analyses. The expected long-term return on plan assets is a long-term assumption that generally is expected to remain the same from one year to the next but is adjusted if there is a material change in the target asset allocation and/or significant changes in fees and expenses paid by the Discover Pension Plan.

Discover Pension Plan Assets

The targeted asset allocation for 2020 by asset class is 72% and 28% for fixed income securities and equity securities, respectively. The Discover Financial Services Retirement Plan Investment Committee (the "Investment Committee") determined the asset allocation targets for the Discover Pension Plan based on its assessment of business and financial conditions, demographic and actuarial data, funding characteristics and related risk factors. Other relevant factors, including industry practices and long-term historical and prospective capital market returns were considered as well.

The Discover Pension Plan return objectives provide long-term measures for monitoring the investment performance against growth in the pension obligations. The overall allocation is expected to help protect the Discover Pension Plan's funded status while generating sufficiently stable real returns (net of inflation) to help cover current and future benefit payments and to improve the Discover Pension Plan's funded status. Total Discover Pension Plan portfolio performance is assessed by comparing actual returns with relevant benchmarks, such as the S&P 500 Index, the S&P 500 Total Return Index, the Russell 2000 Index and the MSCI All Country World Index.

Both the fixed income and equity portions of the asset allocation use a combination of active and passive investment strategies and different investment styles. The fixed income asset allocation consists of longer duration fixed income securities in order to help reduce plan exposure to interest rate variation and to better correlate assets with obligations. The longer duration fixed income allocation is expected to help stabilize the funding status ratio over the long term.

The asset mix of the Discover Pension Plan is reviewed by the Investment Committee on a regular basis. The asset allocation strategy will change over time in response to changes in the Discover Pension Plan's funded status.

Fair Value Measurements

The Discover Pension Plan's assets are stated at fair value. Quoted market prices in active markets are the best evidence of fair value and are used as the basis for the measurement, if available. If a quoted market price is not available, the estimate of the fair value is based on the best information available in the circumstances. The table below presents information about the Discover Pension Plan assets and indicates the level within the fair value hierarchy, as defined by ASC Topic 820, with which each item is associated as of the end of the current period. For a description of the fair value hierarchy, see Note 20: Fair Value Measurements. (dollars in millions):

	Level 1	Level 2	Level 3	Net Asset Value	Total	Net Asset Allocation
Balance at December 31, 2019						
Assets						
Cash	\$ 7	\$ —	\$ —	\$ —	\$ 7	1%
Domestic small/mid cap equity fund	—	6	—	—	6	1%
Emerging markets equity fund	—	—	—	16	16	3%
Global equity fund	—	73	3	45	121	23%
Domestic large cap equity fund	—	8	—	—	8	2%
Long duration credit fund	—	205	—	—	205	39%
Non-core fixed income fund	—	—	64	—	64	12%
U.S. Treasury securities	87	—	—	—	87	17%
Temporary investment fund	—	15	—	—	15	3%
Total assets	94	307	67	61	529	
Liabilities						
Futures contracts	—	4	—	—	4	1%
Total liabilities	—	4	—	—	4	
Net assets	\$ 94	\$ 303	\$ 67	\$ 61	\$ 525	100%
Balance at December 31, 2018						
Assets						
Domestic small/mid cap equity fund	\$ —	\$ 6	\$ —	\$ —	\$ 6	1%
Emerging markets equity fund	—	—	—	17	17	4%
Global equity fund	—	82	—	42	124	27%
Domestic large cap equity fund	—	7	—	—	7	2%
Long duration credit fund	—	125	—	—	125	28%
Futures contracts	—	6	—	—	6	1%
Non-core fixed income fund	—	—	65	—	65	14%
U.S. Treasury securities	59	—	—	—	59	13%
Stable value fund	—	1	—	—	1	—%
Temporary investment fund	—	45	—	—	45	10%
Total assets	\$ 59	\$ 272	\$ 65	\$ 59	\$ 455	100%

Cash Flows

The Company does not expect to make any contributions to the Discover Pension Plan in 2020.

Expected benefit payments associated with the Discover Pension Plan for each of the next five years and in aggregate for the years thereafter are as follows (dollars in millions):

	December 31, 2019
2020	\$ 16
2021	\$ 18
2022	\$ 19
2023	\$ 20
2024	\$ 22
Following five years thereafter	\$ 132

Discover 401(k) Plan

Under the Discover 401(k) Plan, eligible U.S. employees receive 401(k) matching contributions. Eligible employees also receive fixed employer contributions. The pretax expense associated with the Company contributions for the years ended December 31, 2019, 2018 and 2017 was \$87 million, \$69 million and \$64 million, respectively.

12. Common and Preferred Stock**Preferred Stock**

The Company has 5,700 shares of Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Stock, Series C (the “preferred stock”), outstanding with a par value of \$0.01 per share that were issued on October 31, 2017. Each share of preferred stock has a liquidation preference of \$100,000 and is represented by 100 depository shares. Proceeds, net of underwriting discount, received from the preferred stock issuance totaled approximately \$563 million. The preferred stock is redeemable at the Company’s option, subject to regulatory approval, either (1) in whole or in part on any dividend payment date on or after October 30, 2027 or (2) in whole but not in part, at any time within 90 days following a regulatory capital event (as defined in the certificate of designations for the preferred stock), in each case at a redemption price equal to \$100,000 per share of preferred stock plus declared and unpaid dividends. Any dividends declared on the preferred stock will be payable semi-annually in arrears at a rate of 5.50% per annum through October 30, 2027. Thereafter, dividends declared on preferred stock will be payable quarterly in arrears at a floating rate equal to three-month LIBOR plus a spread of 3.076% per annum. On December 1, 2017, the Company redeemed all outstanding shares of the Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B, for an aggregate price of \$575 million and charged to retained earnings \$15 million of original issuance costs.

Stock Repurchase Program

On July 18, 2019, the Company’s Board of Directors approved a share repurchase program authorizing the repurchase of up to \$2.2 billion of its outstanding shares of common stock. The program expires on September 30, 2020 and may be terminated at any time. During the year ended December 31, 2019, the Company repurchased approximately 22 million shares for \$1.7 billion.

13. Accumulated Other Comprehensive Income

Changes in each component of AOCI were as follows (dollars in millions):

	Unrealized Gains (Losses) on Available-for-Sale Investment Securities, Net of Tax	Gains (Losses) on Cash Flow Hedges, Net of Tax	Losses on Pension Plan, Net of Tax	AOCI
For the Year Ended December 31, 2019				
Balance at December 31, 2018	\$ 10	\$ 22	\$ (188)	\$ (156)
Net change	102	(39)	(26)	37
Balance at December 31, 2019	\$ 112	\$ (17)	\$ (214)	\$ (119)
For the Year Ended December 31, 2018				
Balance at December 31, 2017	\$ (5)	\$ 10	\$ (157)	\$ (152)
Cumulative effect of ASU No. 2018-02 adoption ⁽¹⁾	(1)	3	(31)	(29)
Net change	16	9	—	25
Balance at December 31, 2018	\$ 10	\$ 22	\$ (188)	\$ (156)
For the Year Ended December 31, 2017				
Balance at December 31, 2016	\$ (3)	\$ (13)	\$ (145)	\$ (161)
Net change	(2)	23	(12)	9
Balance at December 31, 2017	\$ (5)	\$ 10	\$ (157)	\$ (152)

(1) Represents the adjustment to AOCI as a result of adoption of ASU No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, in the second quarter of 2018.

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The following table presents each component of OCI before reclassifications and amounts reclassified from AOCI for each component of OCI before- and after-tax (dollars in millions):

	Before Tax	Tax (Expense) Benefit	Net of Tax
For the Year Ended December 31, 2019			
Available-for-Sale Investment Securities			
Net unrealized holding gains arising during the period	\$ 135	\$ (33)	\$ 102
Net change	<u>\$ 135</u>	<u>\$ (33)</u>	<u>\$ 102</u>
Cash Flow Hedges			
Net unrealized losses arising during the period	\$ (42)	\$ 7	\$ (35)
Amounts reclassified from AOCI	(5)	1	(4)
Net change	<u>\$ (47)</u>	<u>\$ 8</u>	<u>\$ (39)</u>
Pension Plan			
Unrealized losses arising during the period	\$ (34)	\$ 8	\$ (26)
Net change	<u>\$ (34)</u>	<u>\$ 8</u>	<u>\$ (26)</u>
For the Year Ended December 31, 2018			
Available-for-Sale Investment Securities			
Net unrealized holding gains arising during the period	\$ 23	\$ (7)	\$ 16
Net change	<u>\$ 23</u>	<u>\$ (7)</u>	<u>\$ 16</u>
Cash Flow Hedges			
Net unrealized gains arising during the period	\$ 17	\$ (4)	\$ 13
Amounts reclassified from AOCI	(6)	2	(4)
Net change	<u>\$ 11</u>	<u>\$ (2)</u>	<u>\$ 9</u>
For the Year Ended December 31, 2017			
Available-for-Sale Investment Securities			
Net unrealized holding losses arising during the period	\$ (3)	\$ 1	\$ (2)
Net change	<u>\$ (3)</u>	<u>\$ 1</u>	<u>\$ (2)</u>
Cash Flow Hedges			
Net unrealized gains arising during the period	\$ 23	\$ (9)	\$ 14
Amounts reclassified from AOCI	15	(6)	9
Net change	<u>\$ 38</u>	<u>\$ (15)</u>	<u>\$ 23</u>
Pension Plan			
Unrealized losses arising during the period	\$ (15)	\$ 3	\$ (12)
Net change	<u>\$ (15)</u>	<u>\$ 3</u>	<u>\$ (12)</u>

14. Other Expense

Total other expense includes the following components (dollars in millions):

	For the Years Ended December 31,		
	2019	2018	2017
Postage	\$ 93	\$ 86	\$ 78
Fraud losses and other charges	96	83	89
Supplies	34	29	39
Incentive expense	84	85	37
Other expense	196	186	181
Total other expense	<u>\$ 503</u>	<u>\$ 469</u>	<u>\$ 424</u>

15. Income Taxes

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

	For the Years Ended December 31,		
	2019	2018	2017
Current			
U.S. federal	\$ 836	\$ 839	\$ 1,056
U.S. state and local	175	206	96
Total	1,011	1,045	1,152
Deferred			
U.S. federal	(116)	(163)	288
U.S. state and local	(17)	(27)	(2)
Total	(133)	(190)	286
Income tax expense	<u>\$ 878</u>	<u>\$ 855</u>	<u>\$ 1,438</u>

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

	For the Years Ended December 31,		
	2019	2018	2017
U.S. federal statutory income tax rate	21.0 %	21.0 %	35.0 %
U.S. state, local and other income taxes, net of U.S. federal income tax benefits	3.5	3.6	3.1
Revaluation of net deferred tax assets and other investments due to tax reform ⁽¹⁾	—	—	5.1
Tax credits	(1.4)	(1.3)	(1.3)
Other	(0.2)	0.5	(1.2)
Effective income tax rate	<u>22.9 %</u>	<u>23.8 %</u>	<u>40.7 %</u>

(1) See Note 3: Investments — Other Investments for a description of these investments.

For the year ended December 31, 2019, income tax expense increased \$23 million, or 2.7%, and the effective income tax rate decreased 0.9 percentage points as compared to the year ended December 31, 2018. The increase in income tax expense was primarily driven by increased pretax income. The effective tax rate decreased primarily due to the resolution of certain tax matters.

Income tax expense decreased \$583 million, or 40.5%, and the effective tax rate decreased 16.9 percentage points for the year ended December 31, 2018 as compared to the year ended December 31, 2017. The decrease in both the effective tax rate and income tax expense was primarily due to a reduction in the U.S. federal statutory income tax rate from 35% to 21% and other impacts of the Tax Cuts and Jobs Act of 2017.

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Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. Valuation allowances are provided to reduce deferred tax assets to an amount that is more likely than not to be realized. The Company evaluates the likelihood of realizing its deferred tax assets by estimating sources of future taxable income and the impact of tax planning strategies. Significant components of the Company's net deferred income taxes, which are included in other assets in the consolidated statements of financial condition, were as follows (dollars in millions):

	December 31,	
	2019	2018
Deferred tax assets		
Allowance for loan losses	\$ 819	\$ 730
Compensation and benefits	65	65
Other	50	44
Total deferred tax assets before valuation allowance	934	839
Valuation allowance	(1)	(1)
Total deferred tax assets, net of valuation allowance	933	838
Deferred tax liabilities		
Depreciation and software amortization	(167)	(137)
Customer fees and rewards	(81)	(159)
Unrealized gains	(33)	(8)
Intangibles	(28)	(26)
Deferred loan origination costs	(28)	(23)
Debt exchange premium	(26)	(34)
Other	(19)	(17)
Total deferred tax liabilities	(382)	(404)
Net deferred tax assets	\$ 551	\$ 434

A reconciliation of beginning and ending unrecognized tax benefits is as follows (dollars in millions):

	For the Years Ended December 31,		
	2019	2018	2017
Balance at beginning of period	\$ 83	\$ 123	\$ 158
Additions			
Current year tax positions	4	5	9
Prior year tax positions	—	6	23
Reductions			
Prior year tax positions	(22)	(17)	(41)
Settlements with taxing authorities	—	(25)	(25)
Expired statute of limitations	(4)	(9)	(1)
Balance at end of period⁽¹⁾	\$ 61	\$ 83	\$ 123

(1) For the years ended December 31, 2019, 2018 and 2017, amounts included \$54 million, \$74 million and \$105 million, respectively, of unrecognized tax benefits, which, if recognized, would favorably affect the effective tax rate.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits as a component of income tax expense. Interest and penalties related to unrecognized tax benefits were \$14 million and \$15 million for the years ended December 31, 2019 and 2018, respectively.

The Company is subject to examination by the Internal Revenue Service ("IRS") and tax authorities in various state, local and foreign tax jurisdictions. The Company regularly assesses the likelihood of additional assessments or settlements in each of the taxing jurisdictions resulting from these and subsequent years' examinations. The years 2011-2015 are currently under review by the IRS Office of Appeals. At this time, the potential change in unrecognized tax benefits is not expected to be significant over the next 12 months. The Company believes that its reserves are sufficient to cover any tax, penalties and interest that would result from such examinations.

The Company has an immaterial amount of state net operating loss carryforwards that are subject to a partial valuation allowance as of December 31, 2019 and 2018.

16. Earnings Per Share

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

	For the Years Ended December 31,		
	2019	2018	2017
Numerator			
Net income	\$ 2,957	\$ 2,742	\$ 2,099
Preferred stock dividends	(31)	(31)	(37)
Issuance costs for Series B preferred stock redemption	—	—	(15)
Net income available to common stockholders	2,926	2,711	2,047
Income allocated to participating securities	(18)	(22)	(16)
Net income allocated to common stockholders	\$ 2,908	\$ 2,689	\$ 2,031
Denominator			
Weighted-average shares of common stock outstanding	320	344	374
Effect of dilutive common stock equivalents	—	1	—
Weighted-average shares of common stock outstanding and common stock equivalents	320	345	374
Basic earnings per common share	\$ 9.09	\$ 7.81	\$ 5.43
Diluted earnings per common share	\$ 9.08	\$ 7.79	\$ 5.42

Anti-dilutive securities were not material and had no impact on the computation of diluted EPS for the years ended December 31, 2019, 2018 and 2017.

17. Capital Adequacy

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

The Company and Discover Bank are subject to regulatory and capital rules issued by the Federal Reserve and FDIC, respectively, under the Basel Committee's December 2010 framework ("Basel III rules"). The Basel III rules, which became effective for the Company January 2015, were subject to phase-in periods through the end of 2018, based on the Company being classified as a "Standardized Approach" entity. As of January 1, 2019, the Basel III rules subject to transition have all been fully phased in with the exception of certain transition provisions that were frozen pursuant to regulation issued in November 2017. Pursuant to a final rule issued in July 2019, the transition provisions that were previously frozen will be replaced with new permanent rules effective in April 2020 with the option to early adopt beginning on January 1, 2020.

As of December 31, 2019, the Company and Discover Bank met all Basel III minimum capital ratio requirements to which they were subject. The Company and Discover Bank also met the requirements to be considered "well-capitalized" under Regulation Y and prompt corrective action regulations, respectively, and there have been no conditions or events that management believes have changed the Company's or Discover Bank's category. To be categorized as "well-capitalized," the Company and Discover Bank must maintain minimum capital ratios as set forth in the table below.

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The following table shows the actual capital amounts and ratios of the Company and Discover Bank and comparisons of each to the regulatory minimum and “well-capitalized” requirements (dollars in millions):

	Actual		Minimum Capital Requirements		Capital Requirements To Be Classified as Well-Capitalized	
	Amount	Ratio ⁽¹⁾	Amount	Ratio	Amount ⁽²⁾	Ratio ⁽²⁾
December 31, 2019						
Total capital (to risk-weighted assets)						
Discover Financial Services	\$ 13,250	13.5%	\$ 7,860	≥8.0%	\$ 9,825	≥10.0%
Discover Bank	\$ 13,441	13.8%	\$ 7,776	≥8.0%	\$ 9,720	≥10.0%
Tier 1 capital (to risk-weighted assets)						
Discover Financial Services	\$ 11,595	11.8%	\$ 5,895	≥6.0%	\$ 5,895	≥6.0%
Discover Bank	\$ 11,203	11.5%	\$ 5,832	≥6.0%	\$ 7,776	≥8.0%
Tier 1 capital (to average assets)						
Discover Financial Services	\$ 11,595	10.3%	\$ 4,482	≥4.0%	N/A	N/A
Discover Bank	\$ 11,203	10.1%	\$ 4,435	≥4.0%	\$ 5,544	≥5.0%
Common Equity Tier 1 (to risk-weighted assets)						
Discover Financial Services	\$ 11,032	11.2%	\$ 4,421	≥4.5%	N/A	N/A
Discover Bank	\$ 11,203	11.5%	\$ 4,374	≥4.5%	\$ 6,318	≥6.5%
December 31, 2018						
Total capital (to risk-weighted assets)						
Discover Financial Services	\$ 12,532	13.5%	\$ 7,450	≥8.0%	\$ 9,312	≥10.0%
Discover Bank	\$ 13,106	14.2%	\$ 7,372	≥8.0%	\$ 9,215	≥10.0%
Tier 1 capital (to risk-weighted assets)						
Discover Financial Services	\$ 10,895	11.7%	\$ 5,587	≥6.0%	\$ 5,587	≥6.0%
Discover Bank	\$ 10,834	11.8%	\$ 5,529	≥6.0%	\$ 7,372	≥8.0%
Tier 1 capital (to average assets)						
Discover Financial Services	\$ 10,895	10.1%	\$ 4,308	≥4.0%	N/A	N/A
Discover Bank	\$ 10,834	10.2%	\$ 4,265	≥4.0%	\$ 5,332	≥5.0%
Common Equity Tier 1 (to risk-weighted assets)						
Discover Financial Services	\$ 10,332	11.1%	\$ 4,191	≥4.5%	N/A	N/A
Discover Bank	\$ 10,834	11.8%	\$ 4,147	≥4.5%	\$ 5,990	≥6.5%

(1) Capital ratios are calculated based on the Basel III Standardized Approach rules, subject to applicable transition provisions.

(2) The Basel III rules do not establish well-capitalized thresholds for these measures for bank holding companies. Existing well-capitalized thresholds established in the Federal Reserve’s Regulation Y have been included where available.

The amount of dividends that a bank may pay in any year is subject to certain regulatory restrictions. Under the current banking regulations, a bank may not pay dividends if such a payment would leave the bank inadequately capitalized. Discover Bank paid dividends of \$2.5 billion, \$2.4 billion and \$1.9 billion in the years ended December 31, 2019, 2018 and 2017, respectively, to the Company.

18. Commitments, Contingencies and Guarantees

In the normal course of business, the Company enters into a number of off-balance sheet commitments, transactions and obligations under guarantee arrangements that expose the Company to varying degrees of risk. The Company's commitments, contingencies and guarantee relationships are described below.

Commitments

Unused Credit Arrangements

At December 31, 2019, the Company had unused credit arrangements for loans of approximately \$206.7 billion. Such arrangements arise primarily from agreements with customers for unused lines of credit on certain credit cards and certain other loan products, provided there is no violation of conditions in the related agreements. These arrangements, substantially all of which the Company can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage, customer creditworthiness and loan qualification.

Contingencies

See Note 19: Litigation and Regulatory Matters for a description of potential liability arising from pending litigation or regulatory proceedings involving the Company.

Guarantees

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

Securitizations Representations and Warranties

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

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

Counterparty Settlement Guarantees

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

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

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- *ATM Guarantee.* PULSE entered into contractual relationships with certain international ATM acquirers in which DFS Services LLC retains counterparty exposure if an issuer fails to fulfill its settlement obligation.
- *Network Alliance Guarantee.* Discover Network, Diners Club and PULSE have entered into contractual relationships with certain international payment networks in which DFS Services LLC retains the counterparty exposure if a network fails to fulfill its settlement obligation.

The maximum potential amount of future payments related to such contingent obligations is dependent upon the transaction volume processed between the time a potential counterparty defaults on its settlement and the time at which the Company disables the settlement of any further transactions for the defaulting party. The Company has some contractual remedies to offset these counterparty settlement exposures (such as letters of credit or pledged deposits), however, there is no limitation on the maximum amount the Company may be liable to pay.

The actual amount of the potential exposure cannot be quantified as the Company cannot determine whether particular counterparties will fail to meet their settlement obligations. In the event that all licensees and/or issuers were to become unable to settle their transactions, the Company estimates its maximum potential counterparty exposures to these settlement guarantees would be approximately \$160 million as of December 31, 2019.

The Company believes that the estimated amounts of maximum potential future payments are not representative of the Company's actual potential loss exposure given Diners Club's and PULSE's insignificant historical losses from these counterparty exposures. As of December 31, 2019, the Company had not recorded any contingent liability in the consolidated financial statements for these counterparty exposures and management believes that the probability of any payments under these arrangements is low.

Discover Network Merchant Chargeback Guarantees

The Company operates the Discover Network, issues payment cards and permits third parties to issue payment cards. The Company is contingently liable for certain transactions processed on the Discover Network in the event of a dispute between the payment card customer and a merchant. The contingent liability arises if the disputed transaction involves a merchant or merchant acquirer with whom the Discover Network has a direct relationship. If a dispute is resolved in the customer's favor, the Discover Network will credit or refund the disputed amount to the Discover Network card issuer, who in turn credits its customer's account. The Discover Network will then charge back the disputed amount of the payment card transaction to the merchant or merchant acquirer, where permitted by the applicable agreement, to seek recovery of amounts already paid to the merchant for payment card transactions. If the Discover Network is unable to collect the amount subject to dispute from the merchant or merchant acquirer (e.g., in the event of merchant default or dissolution or after expiration of the time period for chargebacks in the applicable agreement), the Discover Network will bear the loss for the amount credited or refunded to the customer. In most instances, a loss by the Discover Network is unlikely to arise in connection with payments on card transactions because most products or services are delivered when purchased and credits are issued by merchants on returned items in a timely fashion, thus minimizing the likelihood of cardholder disputes with respect to amounts paid by the Discover Network. However, where the product or service is not scheduled to be provided to the customer until a later date following the purchase, the likelihood of a contingent payment obligation by the Discover Network increases. Losses related to merchant chargebacks were not material for the years ended December 31, 2019, 2018 and 2017.

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

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

	For the Years Ended December 31,		
	2019	2018	2017
Aggregate sales transaction volume ⁽¹⁾	\$ 172,463	\$ 158,910	\$ 143,551

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

The Company did not record any contingent liability in the consolidated financial statements for merchant chargeback guarantees as of December 31, 2019 or 2018. The Company mitigates the risk of potential loss exposure by withholding settlement from merchants, obtaining third-party guarantees, or obtaining escrow deposits or letters of credit from certain merchant acquirers or merchants that are considered higher risk due to various factors such as time delays in the delivery of products or services. As of December 31, 2019 and 2018, the Company had escrow deposits and settlement withholdings of \$8 million and \$10 million, respectively, which are recorded in interest-bearing deposit accounts and accrued expenses and other liabilities on the Company's consolidated statements of financial condition.

19. Litigation and Regulatory Matters

In the normal course of business, from time to time, the Company has been named as a defendant in various legal actions, including arbitrations, class actions and other litigation, arising in connection with its activities. Certain of the actual or threatened legal actions include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. The litigation process is not predictable and can lead to unexpected results. The Company contests liability and/or the amount of damages as appropriate in each pending matter.

The Company has historically offered its customers an arbitration clause in its customer agreements. The arbitration clause allows the Company and its customers to quickly and economically resolve disputes. Additionally, the arbitration clause has in some instances limited the costs of, and the Company's exposure to, litigation. Future legal and regulatory challenges and prohibitions may cause the Company to discontinue its offering and use of such clauses. From time to time, the Company is involved in legal actions challenging its arbitration clause. Bills may be periodically introduced in Congress to directly or indirectly prohibit the use of pre-dispute arbitration clauses.

The Company is also involved, from time to time, in other reviews, investigations and proceedings (both formal and informal) by governmental agencies regarding the Company's business including, among other matters, consumer regulatory, accounting, tax and other operational matters, some of which may result in significant adverse judgments, settlements, fines, penalties, injunctions, decreases in regulatory ratings, customer restitution or other relief, which could materially impact the Company's consolidated financial statements, increase its cost of operations, or limit its ability to execute its business strategies and engage in certain business activities. Certain subsidiaries of the Company are subject to a consent order with the Consumer Financial Protection Bureau (the "CFPB") regarding certain student loan servicing practices, as described below. Pursuant to powers granted under federal banking laws, regulatory agencies have broad and sweeping discretion, and may assess civil money penalties, require changes to certain business practices or require customer restitution at any time.

In accordance with applicable accounting guidance, the Company establishes an accrued liability for legal and regulatory matters when those matters present loss contingencies that are both probable and estimable. Litigation and regulatory settlement related expense was not material for the years ended December 31, 2019, 2018 and 2017.

There may be an exposure to loss in excess of any amounts accrued. The Company believes the estimate of the aggregate range of reasonably possible losses (meaning those losses the likelihood of which is more than remote but less than likely) in excess of the amounts that the Company has accrued for legal and regulatory proceedings is up to \$135 million. This estimated range of reasonably possible losses is based upon currently available information for those proceedings in which the Company is involved, takes into account the Company's best estimate of such losses for those matters for which an estimate can be made, and does not represent the Company's maximum potential loss exposure. Various aspects of the legal proceedings underlying the estimated range will change from time to time and actual results may vary significantly from the estimate.

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

On February 13, 2020, the Federal Reserve Board announced that the May 26, 2015 written agreement between the Company and the Federal Reserve Bank of Chicago related to the Company's enterprise-wide anti-money laundering and related compliance programs has been terminated effective February 5, 2020.

On July 22, 2015, the Company announced that its subsidiaries, Discover Bank, SLC and Discover Products Inc. (the "Discover Subsidiaries"), agreed to a consent order with the CFPB resolving the agency's investigation with respect

to certain student loan servicing practices. The order required the Discover Subsidiaries to provide redress of approximately \$16 million to consumers who may have been affected by the activities described in the order related to certain collection calls, overstatements of minimum payment due amounts in billing statements, and provision of interest paid information to consumers, and provide regulatory disclosures with respect to loans acquired in default. In addition, the Discover Subsidiaries were required to pay a \$2.5 million civil money penalty to the CFPB. As required by the consent order, on October 19, 2015, the Discover Subsidiaries submitted to the CFPB a redress plan and a compliance plan designed to ensure that the Discover Subsidiaries provide redress and otherwise comply with the terms of the order. The CFPB is currently investigating Discover Bank's compliance with the order and certain student loan servicing practices. Discover Bank is cooperating with the CFPB in connection with the investigation. Discover Bank is enhancing the compliance plan submitted to the CFPB in 2015. The investigation could lead to a supervisory action, which may result in legal fees, penalties, fines and remediation expenses, and could require Discover Bank to change certain business practices.

On March 8, 2016, a class action lawsuit was filed against the Company, other credit card networks, other issuing banks, and EMVCo in the U.S. District Court for the Northern District of California (B&R Supermarket, Inc., d/b/a Milam's Market, et al. v. Visa, Inc. et al.) alleging a conspiracy by defendants to shift fraud liability to merchants with the migration to the EMV security standard and chip technology. Plaintiffs assert joint and several liability among the defendants and seek unspecified damages, including treble damages, attorneys' fees, costs and injunctive relief. In May 2017, the Court entered an order transferring the entire action to a federal court in New York that is presiding over certain related claims that are pending in the actions consolidated as MDL 1720. On March 11, 2018, the Court entered an order denying the plaintiffs' motion for class certification without prejudice to filing a renewed motion. Plaintiffs filed a renewed motion for class certification on July 16, 2018. Defendants filed their Opposition to Class Certification on March 15, 2019; a hearing date is yet to be scheduled. The Company is not in a position at this time to assess the likely outcome or its exposure, if any, with respect to this matter, but will seek to vigorously defend against all claims asserted by the plaintiffs.

On September 20, 2019, a putative class action was filed against the Company in the Northern District of Illinois (Bonoan v. Discover Financial Services) alleging violations of the Telephone Consumer Protection Act. The plaintiff alleges the Company placed telephone calls to wrong or reassigned cellular telephone numbers without consent. The plaintiff seeks an injunction, statutory damages, treble damages, reasonable attorney fees, costs and expenses. The case was dismissed on November 8, 2019.

20. Fair Value Measurements

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

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

The determination of classification of its financial instruments within the fair value hierarchy is performed at least quarterly by the Company. For transfers in and out of the levels of the fair value hierarchy, the Company discloses the fair value measurement based on the value immediately preceding the transfer.

The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and involves consideration of factors specific to the asset or liability. Furthermore, certain techniques used to measure fair value involve some degree of judgment and, as a result, are not necessarily indicative of the amounts the Company would realize in a current market exchange.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are as follows (dollars in millions):

	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Balance at December 31, 2019				
Assets				
Fair value - OCI				
U.S. Treasury securities	\$ 9,906	\$ —	\$ —	\$ 9,906
Residential mortgage-backed securities - Agency	—	417	—	417
Available-for-sale investment securities	\$ 9,906	\$ 417	\$ —	\$ 10,323
Liabilities				
Fair value - OCI				
Derivative financial instruments - cash flow hedges ⁽¹⁾	\$ —	\$ 2	\$ —	\$ 2
Fair value - Net income				
Derivative financial instruments - fair value hedges ⁽¹⁾	\$ —	\$ 4	\$ —	\$ 4
Derivative financial instruments - foreign exchange forward contracts ⁽¹⁾	\$ —	\$ 1	\$ —	\$ 1
Balance at December 31, 2018				
Assets				
Fair value - OCI				
U.S. Treasury securities	\$ 2,586	\$ —	\$ —	\$ 2,586
Residential mortgage-backed securities - Agency	—	547	—	547
Available-for-sale investment securities	\$ 2,586	\$ 547	\$ —	\$ 3,133
Derivative financial instruments - cash flow hedges ⁽¹⁾	\$ —	\$ 8	\$ —	\$ 8
Fair value - Net income				
Derivative financial instruments - fair value hedges ⁽¹⁾	\$ —	\$ 5	\$ —	\$ 5
Liabilities				
Fair value - OCI				
Derivative financial instruments - cash flow hedges ⁽¹⁾	\$ —	\$ 2	\$ —	\$ 2

(1) Derivative instrument carrying values in an asset or liability position are presented as part of other assets or accrued expenses and other liabilities, respectively, in the Company's consolidated statements of financial condition.

There were no transfers between Levels 1 and 2 within the fair value hierarchy for the years ended December 31, 2019 and 2018.

Available-for-Sale Investment Securities

Investment securities classified as available-for-sale consist of U.S. Treasury securities and residential mortgage-backed securities. The fair value estimates of investment securities classified as Level 1, consisting of U.S. Treasury securities, are determined based on quoted market prices for the same securities. The Company classifies residential mortgage-backed securities as Level 2, the fair value estimates of which are based on the best information available. This data may consist of observed market prices, broker quotes or discounted cash flow models that incorporate assumptions such as benchmark yields, issuer spreads, prepayment speeds, credit ratings and losses, the priority of which may vary based on availability of information.

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

At December 31, 2019, amounts reported in residential mortgage-backed securities reflect government-rated obligations issued by Fannie Mae, Freddie Mac and Ginnie Mae with a par value of \$408 million, a weighted-average coupon of 2.81% and a weighted-average remaining maturity of three years.

Derivative Financial Instruments

The Company's derivative financial instruments consist of interest rate swaps and foreign exchange forward contracts. These instruments are classified as Level 2 as their fair values are estimated using proprietary pricing models, containing certain assumptions based on readily observable market-based inputs, including interest rate curves, option volatility and foreign currency forward and spot rates. In determining fair values, the pricing models use widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity and the observable market-based inputs. The fair values of the interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments are based on an expectation of future interest rates derived from the observable market interest rate curves. The Company considers collateral and master netting agreements that mitigate credit exposure to counterparties in determining the counterparty credit risk valuation adjustment. The fair values of the currency instruments are valued comparing the contracted forward exchange rate pertaining to the specific contract maturities to the current market exchange rate.

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

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include those associated with acquired businesses, including goodwill and other intangible assets. For these assets, measurement at fair value in periods subsequent to the initial recognition of the assets is applicable if one or more of the assets is determined to be impaired. The Company had no material impairments related to these assets during the years ended December 31, 2019 and 2018.

Financial Instruments Measured at Other Than Fair Value

The following tables disclose the estimated fair value of the Company's financial assets and financial liabilities that are not required to be carried at fair value (dollars in millions):

Balance at December 31, 2019	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Carrying Value
Assets					
Amortized cost					
Residential mortgage-backed securities - Agency	\$ —	\$ 274	\$ —	\$ 274	\$ 272
Held-to-maturity investment securities	\$ —	\$ 274	\$ —	\$ 274	\$ 272
Net loan receivables	\$ —	\$ —	\$ 96,094	\$ 96,094	\$ 92,511
Carrying value approximates fair value⁽¹⁾					
Cash and cash equivalents	\$ 6,924	\$ —	\$ —	\$ 6,924	\$ 6,924
Restricted cash	\$ 40	\$ —	\$ —	\$ 40	\$ 40
Accrued interest receivables ⁽²⁾	\$ —	\$ 1,044	\$ —	\$ 1,044	\$ 1,044
Liabilities					
Amortized cost					
Time deposits ⁽³⁾	\$ —	\$ 34,910	\$ —	\$ 34,910	\$ 34,381
Long-term borrowings - owed to securitization investors	\$ —	\$ 14,211	\$ 172	\$ 14,383	\$ 14,284
Other long-term borrowings	\$ —	\$ 12,189	\$ —	\$ 12,189	\$ 11,417
Long-term borrowings	\$ —	\$ 26,400	\$ 172	\$ 26,572	\$ 25,701
Carrying value approximates fair value⁽¹⁾					
Accrued interest payables ⁽²⁾	\$ —	\$ 283	\$ —	\$ 283	\$ 283

(1) The carrying values of these assets and liabilities approximate fair value due to the nature of their liquidity (i.e., due or payable in less than one year).

(2) Accrued interest receivable and payable carrying values are presented as part of other assets or accrued expenses and other liabilities, respectively, in the Company's consolidated statements of financial condition.

(3) Excludes deposits without contractually defined maturities for all periods presented.

The following tables disclose the estimated fair value of the Company's financial assets and financial liabilities that are not required to be carried at fair value (dollars in millions):

Balance at December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total	Carrying Value
Assets					
Amortized cost					
Residential mortgage-backed securities - Agency	\$ —	\$ 233	\$ —	\$ 233	\$ 237
Held-to-maturity investment securities	\$ —	\$ 233	\$ —	\$ 233	\$ 237
Net loan receivables	\$ —	\$ —	\$ 90,787	\$ 90,787	\$ 87,471
Carrying value approximates fair value⁽¹⁾					
Cash and cash equivalents	\$ 13,299	\$ —	\$ —	\$ 13,299	\$ 13,299
Restricted cash	\$ 1,846	\$ —	\$ —	\$ 1,846	\$ 1,846
Accrued interest receivables ⁽²⁾	\$ —	\$ 951	\$ —	\$ 951	\$ 951
Liabilities					
Amortized cost					
Time deposits ⁽³⁾	\$ —	\$ 34,635	\$ —	\$ 34,635	\$ 34,788
Long-term borrowings - owed to securitization investors	\$ —	\$ 16,701	\$ 217	\$ 16,918	\$ 16,917
Other long-term borrowings	\$ —	\$ 10,325	\$ —	\$ 10,325	\$ 10,311
Long-term borrowings	\$ —	\$ 27,026	\$ 217	\$ 27,243	\$ 27,228
Carrying value approximates fair value⁽¹⁾					
Accrued interest payables ⁽²⁾	\$ —	\$ 292	\$ —	\$ 292	\$ 292

(1) The carrying values of these assets and liabilities approximate fair value due to the nature of their liquidity (i.e., due or payable in less than one year).

(2) Accrued interest receivable and payable carrying values are presented as part of other assets or accrued expenses and other liabilities, respectively, in the Company's consolidated statements of financial condition.

(3) Excludes deposits without contractually defined maturities for all periods presented.

21. Derivatives and Hedging Activities

The Company uses derivatives to manage its exposure to various financial risks. The Company does not enter into derivatives for trading or speculative purposes. Certain derivatives used to manage the Company's exposure to foreign currency are not designated as hedges and do not qualify for hedge accounting.

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

All derivatives are recorded in other assets at their gross positive fair values and in accrued expenses and other liabilities at their gross negative fair values. See Note 20: Fair Value Measurements for a description of the valuation methodologies of derivatives. Cash collateral amounts associated with derivative positions that are cleared through an exchange are legally characterized as settlement of the derivative positions. Such collateral amounts are reflected as

offsets to the associated derivatives balances recorded in other assets or in accrued expenses and other liabilities. Other cash collateral posted and held balances are recorded in other assets and deposits, respectively, in the consolidated statements of financial condition. Collateral amounts recorded in the consolidated statements of financial condition are based on the net collateral posted or held position for each applicable legal entity's master netting arrangement with each counterparty.

Derivatives Designated as Hedges

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

Cash Flow Hedges

The Company uses interest rate swaps to manage its exposure to changes in interest rates related to future cash flows resulting from interest payments on credit card securitized debt and deposits. The Company's outstanding cash flow hedges are for an initial maximum period of seven years for deposits. The derivatives are designated as hedges of the risk of changes in cash flows on the Company's Federal Funds rate-based interest payments, and qualify for hedge accounting in accordance with ASC Topic 815, *Derivatives and Hedging* ("ASC 815").

The change in the fair value of derivatives designated as cash flow hedges is recorded in OCI and is subsequently reclassified into earnings in the period that the hedged forecasted cash flows affect earnings. Amounts reported in AOCI related to derivatives at December 31, 2019 will be reclassified to interest expense as interest payments are accrued on certain of the Company's floating-rate securitized debt and deposits. During the next 12 months, the Company estimates it will reclassify \$5 million of pretax expense to interest expense related to its derivatives designated as cash flow hedges.

Fair Value Hedges

The Company is exposed to changes in fair value of its fixed-rate debt obligations due to changes in interest rates. The Company uses interest rate swaps to manage its exposure to changes in fair value of certain fixed-rate long-term borrowings, including securitized debt and bank notes, attributable to changes in LIBOR or OIS rate, benchmark interest rates as defined by ASC 815. These interest rate swaps qualify as fair value hedges in accordance with ASC 815. Changes in both (i) the fair values of the derivatives and (ii) the hedged long-term borrowings and deposits relating to the risk being hedged are recorded in interest expense. The changes generally provide substantial offset to one another, with any difference in interest expense.

Derivatives Not Designated as Hedges

Foreign Exchange Forward Contracts

The Company has foreign exchange forward contracts that are economic hedges and are not designated as accounting hedges. The Company enters into foreign exchange forward contracts to manage foreign currency risk. Changes in the fair value of these contracts are recorded in other income.

Derivatives Cleared Through an Exchange

The legal characterization of cash variation margin payments on derivatives cleared through an exchange are legally considered settlement payments and are accounted for with corresponding derivative positions as one unit of account and not separately as collateral. With settlement payments on derivative positions cleared through this exchange reflected as offsets to the associated derivative asset and liability balances, the fair values of derivative instruments and collateral balances shown are generally reduced.

Derivatives Activity

The following table summarizes the fair value (including accrued interest) and outstanding notional amounts of derivative instruments and related collateral balances (dollars in millions):

	December 31, 2019				December 31, 2018		
	Notional Amount	Number of Outstanding Derivative Contracts	Derivative Assets	Derivative Liabilities	Notional Amount	Derivative Assets	Derivative Liabilities
Derivatives designated as hedges							
Interest rate swaps—cash flow hedge	\$ 900	3	\$ —	\$ 2	\$ 2,450	\$ 8	\$ 2
Interest rate swaps—fair value hedge	\$ 14,275	18	—	4	\$ 8,000	5	—
Derivatives not designated as hedges							
Foreign exchange forward contracts ⁽¹⁾	\$ 38	7	—	1	\$ 33	—	—
Total gross derivative assets/liabilities ⁽²⁾			—	7		13	2
Less: collateral held/posted ⁽³⁾			—	(7)		(8)	(2)
Total net derivative assets/liabilities			\$ —	\$ —		\$ 5	\$ —

(1) The foreign exchange forward contracts have notional amounts of EUR 9 million, GBP 14 million, SGD 1 million and INR 596 million as of December 31, 2019 and notional amounts of EUR 9 million, GBP 12 million, SGD 1 million and INR 464 million as of December 31, 2018.

(2) In addition to the derivatives disclosed in the table, the Company enters into forward contracts to purchase when-issued mortgage-backed securities as part of its community reinvestment initiatives. At December 31, 2019, the Company had two outstanding contracts with a total notional amount of \$42 million and immaterial fair value. At December 31, 2018, the Company had one outstanding contract with a notional amount of \$79 million and immaterial fair value.

(3) Collateral amounts, which consist of both cash and investment securities, are limited to the related derivative asset/liability balance and do not include excess collateral received/pledged.

The following amounts were recorded on the statements of financial condition related to cumulative basis adjustment for fair value hedges (dollars in millions):

	December 31, 2019		December 31, 2018	
	Carrying Amount of Hedged Assets/Liabilities	Cumulative Amount of Fair Value Hedging Adjustment Increasing (Decreasing) the Carrying Amount of Hedged Assets/Liabilities	Carrying Amount of Hedged Assets/Liabilities	Cumulative Amount of Fair Value Hedging Adjustment Increasing (Decreasing) the Carrying Amount of Hedged Assets/Liabilities
Long-term borrowings	\$ 14,244	\$ 13	\$ 7,893	\$ (91)

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The following table summarizes the impact of the derivative instruments on income and indicates where within the consolidated financial statements such impact is reported (dollars in millions):

	Location and Amount of (Losses) Gains Recognized in Income		
	Interest (Expense)		
	Deposits	Long-Term Borrowings	Other Income
For the Year Ended December 31, 2019			
Total amounts of income and expense line items presented in the statements of income in which the effects of fair value or cash flow hedges are recorded	\$ (1,587)	\$ (943)	\$ 90
The effects of cash flow and fair value hedging			
Gains on cash flow hedging relationship			
Amounts reclassified from OCI into earnings	\$ 3	\$ 2	\$ —
Gains (losses) on fair value hedging relationship			
Gains (losses) on hedged items	\$ —	\$ (104)	\$ —
Gains on interest rate swaps	—	72	—
Total gains (losses) on fair value hedges	\$ —	\$ (32)	\$ —
The effects of derivatives not designated in hedging relationships			
Gains (losses) on derivatives not designated as hedges	\$ —	\$ —	\$ (1)
For the Year Ended December 31, 2018			
Total amounts of income and expense line items presented in the statements of income in which the effects of fair value or cash flow hedges are recorded	\$ (1,238)	\$ (901)	\$ 97
The effects of cash flow and fair value hedging			
Gains on cash flow hedging relationship			
Amounts reclassified from OCI into earnings	\$ —	\$ 6	\$ —
Gains (losses) on fair value hedging relationship			
Gains (losses) on hedged items	\$ —	\$ (18)	\$ —
Gains (losses) on interest rate swaps	—	(23)	—
Total gains (losses) on fair value hedges	\$ —	\$ (41)	\$ —
The effects of derivatives not designated in hedging relationships			
Gains on derivatives not designated as hedges	\$ —	\$ —	\$ 1

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The following table summarizes the impact of the derivative instruments on income and indicates where within the consolidated financial statements such impact is reported (dollars in millions):

	Location and Amount of (Losses) Gains Recognized in Income		
	Interest (Expense)		
	Deposits	Long-Term Borrowings	Other Income
For the Year Ended December 31, 2017			
Total amounts of income and expense line items presented in the statements of income in which the effects of fair value or cash flow hedges are recorded	\$ (846)	\$ (802)	\$ 92
The effects of cash flow and fair value hedging			
(Losses) gains on cash flow hedging relationship			
Amounts reclassified from OCI into earnings	\$ (8)	\$ (7)	\$ —
Gains (losses) on fair value hedging relationship			
Gains on hedged items	\$ —	\$ 37	\$ —
(Losses) gains on interest rate swaps	(1)	(28)	—
Total (losses) gains on fair value hedges	\$ (1)	\$ 9	\$ —
The effects of derivatives not designated in hedging relationships			
Gains (losses) on derivatives not designated as hedges	\$ —	\$ —	\$ (2)

For the impact of the derivative instruments on OCI, see Note 13: Accumulated Other Comprehensive Income.

Collateral Requirements and Credit-Risk Related Contingency Features

The Company has master netting arrangements and minimum collateral posting thresholds with its counterparties for its fair value and cash flow hedge interest rate swaps and foreign exchange forward contracts. The Company has not sought a legal opinion in relation to the enforceability of its master netting arrangements and, as such, does not report any of these positions on a net basis. Collateral is required by either the Company or its subsidiaries or the counterparty depending on the net fair value position of these derivatives held with that counterparty. The Company may also be required to post collateral with a counterparty for its fair value and cash flow hedge interest rate swaps depending on the credit rating it or Discover Bank receives from specified major credit rating agencies. These collateral receivable or payable amounts are generally not offset against the fair value of these derivatives, but are recorded separately in other assets or deposits. Most of the Company's cash collateral amounts relate to positions cleared through an exchange and are reflected as offsets to the associated derivatives balances recorded in other assets and accrued expenses and other liabilities.

At December 31, 2019, Discover Bank's credit rating met specified thresholds set by its counterparties. However, if its credit rating is reduced below investment grade, Discover Bank would be required to post additional collateral. The amount of additional collateral as of December 31, 2019 would have been \$20 million. DFS (Parent Company) had no outstanding derivatives as of December 31, 2019, and therefore, no collateral was required.

The Company also has agreements with certain of its derivative counterparties that contain a provision where if the Company defaults on any of its indebtedness, including default where repayment of the indebtedness has not been accelerated by the lender, then the Company could also be declared in default on its derivative obligations.

22. Segment Disclosures

The Company's business activities are managed in two segments: Direct Banking and Payment Services.

- *Direct Banking:* The Direct Banking segment includes Discover-branded credit cards issued to individuals on the Discover Network and other consumer products and services, including private student loans, personal loans, home equity loans, 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.
- *Payment Services:* The Payment Services segment includes PULSE, an automated teller machine, debit and electronic funds transfer network; Diners Club, a global payments network; and the Company's Network Partners business, which provides payment transaction processing and settlement services on the Discover Network. The majority of Payment Services revenues relate to transaction processing revenue from PULSE and royalty and licensee revenue from Diners Club.

The business segment reporting provided to and used by the Company's chief operating decision maker is prepared using the following principles and allocation conventions:

- The Company aggregates operating segments when determining reportable segments.
- Corporate overhead is not allocated between segments; all corporate overhead is included in the Direct Banking segment.
- Through its operation of the Discover Network, the Direct Banking segment incurs fixed marketing, servicing and infrastructure costs that are not specifically allocated among the segments, with the exception of an allocation of direct and incremental costs driven by the Company's Payment Services segment.
- The assets of the Company are not allocated among the operating segments in the information reviewed by the Company's chief operating decision maker.
- The revenues of each segment are derived from external sources. The segments do not earn revenue from intercompany sources.
- Income taxes are not specifically allocated between the operating segments in the information reviewed by the Company's chief operating decision maker.

The following table presents segment data (dollars in millions):

	Direct Banking	Payment Services	Total
For the Year Ended December 31, 2019			
Interest income			
Credit card loans	\$ 9,690	\$ —	\$ 9,690
Private student loans	698	—	698
PCI student loans	119	—	119
Personal loans	983	—	983
Other	502	1	503
Total interest income	11,992	1	11,993
Interest expense	2,530	—	2,530
Net interest income	9,462	1	9,463
Provision for loan losses	3,233	(2)	3,231
Other income	1,648	348	1,996
Other expense	4,231	162	4,393
Income before income tax expense	\$ 3,646	\$ 189	\$ 3,835
For the Year Ended December 31, 2018			
Interest income			
Credit card loans	\$ 8,835	\$ —	\$ 8,835
Private student loans	614	—	614
PCI student loans	139	—	139
Personal loans	935	—	935
Other	369	1	370
Total interest income	10,892	1	10,893
Interest expense	2,139	—	2,139
Net interest income	8,753	1	8,754
Provision for loan losses	3,035	—	3,035
Other income	1,645	310	1,955
Other expense	3,918	159	4,077
Income before income tax expense	\$ 3,445	\$ 152	\$ 3,597

The following table presents segment data (dollars in millions):

	Direct Banking	Payment Services	Total
For the Year Ended December 31, 2017			
Interest income			
Credit card loans	\$ 7,907	\$ —	\$ 7,907
Private student loans	523	—	523
PCI student loans	159	—	159
Personal loans	860	—	860
Other	199	—	199
Total interest income	9,648	—	9,648
Interest expense	1,648	—	1,648
Net interest income	8,000	—	8,000
Provision for loan losses	2,586	(7)	2,579
Other income	1,607	290	1,897
Other expense	3,629	152	3,781
Income before income tax expense	\$ 3,392	\$ 145	\$ 3,537

23. Revenue from Contracts with Customers

ASC Topic 606, *Revenue from Contracts with Customers* ("ASC 606"), generally applies to the sales of any good or service for which no other specific accounting guidance is provided. ASC 606 defines 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. The Company's revenue that is subject to this model includes discount and interchange, protection products fees, transaction processing revenue, and amounts classified as other income.

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The following table presents revenue from contracts with customers disaggregated by business segment and reconciles revenue from contracts with customers to total other income (dollars in millions):

	Direct Banking	Payment Services	Total
For the Year Ended December 31, 2019			
Other income subject to ASC 606			
Discount and interchange revenue, net ⁽¹⁾	\$ 1,000	\$ 66	\$ 1,066
Protection products revenue	194	—	194
Transaction processing revenue	—	197	197
Other income	8	85	93
Total other income subject to ASC 606 ⁽²⁾	1,202	348	1,550
Other income not subject to ASC 606			
Loan fee income	449	—	449
Other income	(3)	—	(3)
Total other income not subject to ASC 606	446	—	446
Total other income by operating segment	\$ 1,648	\$ 348	\$ 1,996
For the Year Ended December 31, 2018			
Other income subject to ASC 606			
Discount and interchange revenue, net ⁽¹⁾	\$ 1,022	\$ 52	\$ 1,074
Protection products revenue	204	—	204
Transaction processing revenue	—	178	178
Other income	17	80	97
Total other income subject to ASC 606 ⁽²⁾	1,243	310	1,553
Other income not subject to ASC 606			
Loan fee income	402	—	402
Total other income not subject to ASC 606	402	—	402
Total other income by operating segment	\$ 1,645	\$ 310	\$ 1,955
For the Year Ended December 31, 2017			
Other income subject to ASC 606			
Discount and interchange revenue, net ⁽¹⁾	\$ 1,009	\$ 43	\$ 1,052
Protection products revenue	223	—	223
Transaction processing revenue	—	167	167
Other income	9	80	89
Total other income subject to ASC 606 ⁽²⁾	1,241	290	1,531
Other income not subject to ASC 606			
Loan fee income	363	—	363
Other income	3	—	3
Total other income not subject to ASC 606	366	—	366
Total other income by operating segment	\$ 1,607	\$ 290	\$ 1,897

(1) Net of rewards, including Cashback Bonus rewards, of \$1.9 billion, \$1.8 billion and \$1.6 billion for the years ended December 31, 2019, 2018 and 2017, respectively.

(2) Excludes \$3 million, \$3 million and \$2 million deposit product fees that are reported within net interest income for the years ended December 31, 2019, 2018 and 2017, respectively.

For a detailed description of the Company's significant revenue recognition accounting policies, see Note 2: Summary of Significant Accounting Policies.

24. Related Party Transactions

In the ordinary course of business, the Company offers consumer financial products to its directors, executive officers and certain members of their families. These products are offered on substantially the same terms as those prevailing at the time for comparable transactions with unrelated parties, and these receivables are included in the loan receivables in the Company's consolidated statements of financial condition. They were not material to the Company's financial position or results of operations.

25. Parent Company Condensed Financial Information

The following Parent Company financial statements are provided in accordance with SEC rules, which require such disclosure when the restricted net assets of consolidated subsidiaries exceed 25% of consolidated net assets.

**Discover Financial Services
(Parent Company Only)
Condensed Statements of Financial Condition**

	December 31,	
	2019	2018
	(dollars in millions)	
Assets		
Cash and cash equivalents ⁽¹⁾	\$ 2,511	\$ 1,586
Restricted cash	20	20
Notes receivable from subsidiaries ⁽²⁾	877	821
Investments in bank subsidiaries	11,319	10,891
Investments in non-bank subsidiaries	820	752
Other assets	600	676
Total assets	\$ 16,147	\$ 14,746
Liabilities and Stockholders' Equity		
Non-interest bearing deposit accounts	\$ 2	\$ 4
Short-term borrowings from subsidiaries	283	240
Long-term borrowings	3,636	3,089
Accrued expenses and other liabilities	367	283
Total liabilities	4,288	3,616
Stockholders' equity	11,859	11,130
Total liabilities and stockholders' equity	\$ 16,147	\$ 14,746

(1) The Parent Company had \$2.4 billion and \$1.4 billion in a money market deposit account at Discover Bank as of December 31, 2019 and 2018, respectively, which is included in cash and cash equivalents. These funds are available to the Parent for liquidity purposes.

(2) The Parent Company advanced \$500 million to Discover Bank as of December 31, 2019 and 2018, which is included in notes receivable from subsidiaries. These funds are available to the Parent for liquidity purposes.

Discover Financial Services
(Parent Company Only)
Condensed Statements of Income

	For the Years Ended December 31,		
	2019	2018	2017
	(dollars in millions)		
Interest income	\$ 82	\$ 67	\$ 55
Interest expense	212	189	178
Net interest expense	(130)	(122)	(123)
Dividends from bank subsidiaries	2,530	2,375	1,895
Dividends from non-bank subsidiaries	100	450	15
Total income	2,500	2,703	1,787
Other expense	1	—	—
Income before income tax benefit and equity in undistributed net income of subsidiaries	2,499	2,703	1,787
Income tax benefit	25	33	40
Equity in undistributed net income of subsidiaries	433	6	272
Net income	2,957	2,742	2,099
OCI, net	37	25	9
Comprehensive income	<u>\$ 2,994</u>	<u>\$ 2,767</u>	<u>\$ 2,108</u>

Discover Financial Services
(Parent Company Only)
Condensed Statements of Cash Flows

	For the Years Ended December 31,		
	2019	2018	2017
	(dollars in millions)		
Cash flows from operating activities			
Net income	\$ 2,957	\$ 2,742	\$ 2,099
Adjustments to reconcile net income to net cash provided by operating activities			
Equity in undistributed net income of subsidiaries	(433)	(6)	(272)
Stock-based compensation expense	69	81	75
Deferred income taxes	(8)	(5)	1
Depreciation and amortization	38	34	31
Changes in assets and liabilities			
Decrease (increase) in other assets	92	(416)	(54)
Increase (decrease) in other liabilities and accrued expenses	50	(129)	43
Net cash provided by operating activities	2,765	2,301	1,923
Cash flows from investing activities			
Decrease (increase) in investment in subsidiaries	—	(3)	—
Increase in loans to subsidiaries	(55)	(62)	(8)
Net cash used for investing activities	(55)	(65)	(8)
Cash flows from financing activities			
Net increase (decrease) in short-term borrowings from subsidiaries	42	(110)	130
Proceeds from issuance of common stock	7	6	5
Proceeds from issuance of long-term borrowings	595	49	1,127
Maturities and repayment of long-term borrowings	(86)	(6)	(404)
Purchases of treasury stock	(1,768)	(2,065)	(2,081)
Net (decrease) increase in deposits	(2)	1	(11)
Proceeds from issuance of preferred stock	—	—	563
Payments on redemption of preferred stock	—	—	(575)
Dividends paid on common and preferred stock	(573)	(552)	(527)
Net cash used for financing activities	(1,785)	(2,677)	(1,773)
Increase (decrease) in cash, cash equivalents and restricted cash	925	(441)	142
Cash, cash equivalents and restricted cash, at beginning of period	1,606	2,047	1,905
Cash, cash equivalents and restricted cash, at end of period	\$ 2,531	\$ 1,606	\$ 2,047
Reconciliation of cash, cash equivalents and restricted cash			
Cash and cash equivalents	\$ 2,511	\$ 1,586	\$ 2,043
Restricted cash	20	20	4
Cash, cash equivalents and restricted cash, at end of period	\$ 2,531	\$ 1,606	\$ 2,047
Supplemental disclosure of cash flow information			
Cash paid during the period for			
Interest expense	\$ 170	\$ 156	\$ 132
Income taxes, net of income tax refunds	\$ 20	\$ (22)	\$ (27)

26. Subsequent Events

The Company has evaluated events and transactions that have occurred subsequent to December 31, 2019 and determined that there were no subsequent events that would require recognition or disclosure in the consolidated financial statements.

27. Quarterly Results

The following table provides unaudited quarterly results (dollars in millions, except per share data):

	December 31, 2019	September 30, 2019	June 30, 2019	March 31, 2019	December 31, 2018	September 30, 2018	June 30, 2018	March 31, 2018
Interest income	\$ 3,039	\$ 3,040	\$ 2,977	\$ 2,937	\$ 2,907	\$ 2,781	\$ 2,636	\$ 2,569
Interest expense	615	638	645	632	605	558	507	469
Net interest income	2,424	2,402	2,332	2,305	2,302	2,223	2,129	2,100
Provision for loan losses	836	799	787	809	800	742	742	751
Other income	520	498	520	458	505	501	474	475
Other expense	1,184	1,107	1,078	1,024	1,110	1,015	984	968
Income before income tax expense	924	994	987	930	897	967	877	856
Income tax expense	216	224	234	204	210	247	208	190
Net income	\$ 708	\$ 770	\$ 753	\$ 726	\$ 687	\$ 720	\$ 669	\$ 666
Net income allocated to common stockholders ⁽¹⁾	\$ 704	\$ 749	\$ 747	\$ 705	\$ 681	\$ 699	\$ 663	\$ 646
Basic earnings per common share ⁽¹⁾	\$ 2.25	\$ 2.36	\$ 2.32	\$ 2.15	\$ 2.04	\$ 2.05	\$ 1.91	\$ 1.82
Diluted earnings per common share ⁽¹⁾	\$ 2.25	\$ 2.36	\$ 2.32	\$ 2.15	\$ 2.03	\$ 2.05	\$ 1.91	\$ 1.82

(1) Because the inputs to net income allocated to common stockholders and earnings per share are calculated using weighted averages for the quarter, the sum of all four quarters may differ from the year to date amounts in the consolidated statements of income.

Glossary of Acronyms

- **ALCO:** Asset and Liability Management Committee
- **AOI:** Accumulated Other Comprehensive Income
- **ASC:** Accounting Standards Codification
- **ASU:** Accounting Standards Update
- **BCBS:** Basel Committee on Banking Supervision
- **CCAR:** Comprehensive Capital Analysis and Review
- **CCB:** Capital Conservation Buffer
- **CCPA:** California Consumer Privacy Act
- **CECL:** Current Expected Credit Loss
- **CEO:** Chief Executive Officer
- **CET1:** Common Equity Tier 1
- **CFPB:** Consumer Financial Protection Bureau
- **COSO:** Committee of Sponsoring Organizations of the Treadway Commission
- **CRM:** Corporate Risk Management
- **CRO:** Chief Risk Officer
- **DCENT:** Discover Card Execution Note Trust
- **DCMT:** Discover Card Master Trust
- **DFS:** Discover Financial Services
- **EGRRCPA:** Economic Growth, Regulatory Relief, and Consumer Protection Act
- **EPS:** Earnings Per Share
- **EWI:** Early Warning Indicator
- **FASB:** Financial Accounting Standards Board
- **FDIA:** Federal Deposit Insurance Act
- **FDIC:** Federal Deposit Insurance Corporation
- **FFIEC:** Federal Financial Institutions Examination Council
- **GAAP:** Generally Accepted Accounting Principles
- **IRS:** Internal Revenue Service
- **KRI:** Key Risk Indicator
- **LFI:** Large Financial Institution
- **LIBOR:** London Interbank Offered Rate
- **OCI:** Other Comprehensive Income
- **OIS:** Overnight Index Swap
- **PCAOB:** Public Company Accounting Oversight Board
- **PCD:** Purchased Credit-Deteriorated
- **PCI:** Purchased Credit-Impaired
- **POS:** Point-of-sale
- **PSU:** Performance Stock Unit
- **RSU:** Restricted Stock Unit
- **SEC:** Securities and Exchange Commission
- **SLC:** The Student Loan Corporation
- **TDR:** Troubled Debt Restructuring
- **VIE:** Variable Interest Entity

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), which are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) for the Company. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. There are inherent limitations to the effectiveness of any system of internal control over financial reporting. These limitations include the possibility of human error, the circumvention or overriding of the system and reasonable resource constraints. Because of its inherent limitations, our internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2019. In making this assessment, management used the criteria set forth in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on management’s assessments and those criteria, management has concluded that our internal control over financial reporting was effective as of December 31, 2019.

The effectiveness of our internal control over financial reporting as of December 31, 2019 has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, and the firm’s report on this matter is included in Item 8 of this annual report on Form 10-K.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f) and 15d-15(f)) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information

None.

Part III.

Part III | Item 10. Directors, Executive Officers and Corporate Governance

Information regarding our executive officers is included under the heading “Information About Our Executive Officers” in Item 1 of this annual report on Form 10-K. Information regarding our directors and corporate governance under the following captions in our proxy statement for our annual meeting of stockholders to be held on May 14, 2020 (“Proxy Statement”) is incorporated by reference herein.

“Corporate Governance — Information Concerning Nominees for Election as Directors”

“Corporate Governance — Process for Nominating Directors — Shareholder Recommendations for Director Candidates”

“Corporate Governance — Board Roles and Responsibilities — Board and Committee Meetings”

Our Code of Ethics and Business Conduct applies to all directors, officers and employees, including our Chief Executive Officer and our Chief Financial Officer. You can find our Code of Ethics and Business Conduct on our internet site, *www.discover.com*. We will post any amendments to the Code of Ethics and Business Conduct, and any waivers that are required to be disclosed by the rules of either the SEC or the New York Stock Exchange, on our internet site.

Item 11. Executive Compensation

Information regarding executive compensation under the following captions in our Proxy Statement is incorporated by reference herein.

“Corporate Governance — Director Compensation”

“Executive Compensation”

“Compensation Discussion and Analysis”

“2019 Executive Compensation Tables”

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information relating to the compensation plans under which our equity securities are authorized for issuance as of December 31, 2019, is set forth in the table below.

Plan Category	Number of securities to be issued upon exercise of outstanding warrants and rights ⁽¹⁾	Weighted-average exercise price of outstanding warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	2,872,509	N/A	24,124,453
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	2,872,509	N/A	24,124,453

(1) Includes 2,148,976 vested and unvested restricted stock units and 723,533 vested and unvested performance stock units that can be converted to up to 1.5 shares per each unit dependent on the performance factor.

Information related to the beneficial ownership of our common stock is presented under the caption “Stock Ownership Information — Beneficial Ownership of Company Common Stock” in our Proxy Statement and is incorporated by reference herein.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information regarding certain relationships and related transactions, and director independence under the following captions in our Proxy Statement is incorporated by reference herein.

“Other Matters — Certain Transactions”

“Corporate Governance — Information Concerning Nominees for Election as Directors — Director Independence”

Item 14. Principal Accounting Fees and Services

Information regarding principal accounting fees and services in our Proxy Statement is incorporated by reference herein.

Part IV.

Part IV | Item 15. Exhibits, Financial Statement Schedules

(a) Documents filed as part of this Form 10-K:

1. Consolidated Financial Statements

The consolidated financial statements required to be filed in this annual report on Form 10-K are listed below and appear on pages 71 through 141 herein.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Reports of Independent Registered Public Accounting Firm	71
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Consolidated Statements of Income for the years ended December 31, 2019, 2018 and 2017	76
Consolidated Statements of Comprehensive Income for the years ended December 31, 2019, 2018 and 2017	77
Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2019, 2018 and 2017	78
Consolidated Statements of Cash Flows for the years ended December 31, 2019, 2018 and 2017	79
Notes to the Consolidated Financial Statements	80

2. Financial Statement Schedules

Separate financial statement schedules have been omitted either because they are not applicable or because the required information is included in the consolidated financial statements.

3. Exhibits

See the Exhibit Index below for a list of the exhibits being filed or furnished with or incorporated by reference into this annual report on Form 10-K.

Exhibit Index

Exhibit Number	Description
2.1*	Separation and Distribution Agreement, dated as of June 29, 2007, between Morgan Stanley and Discover Financial Services (filed as Exhibit 2.1 to Discover Financial Services' Current Report on Form 8-K filed on July 5, 2007 and incorporated herein by reference thereto), as amended by the First Amendment to the Separation and Distribution Agreement dated as of June 29, 2007 between Discover Financial Services and Morgan Stanley, dated February 11, 2010 (filed as Exhibit 10.2 to Discover Financial Services' Current Report on Form 8-K filed on February 12, 2010 and incorporated herein by reference thereto).
2.2*	Agreement for the Sale and Purchase of the Goldfish Credit Card Business, dated February 7, 2008, among Discover Financial Services, Goldfish Bank Limited, Discover Bank, SCFC Receivables Corporation, and Barclays Bank Plc (filed as Exhibit 2.1 to Discover Financial Services' Current Report on Form 8-K filed on February 7, 2008 and incorporated herein by reference thereto), as amended and restated by Amended and Restated Agreement for the Sale and Purchase of the Goldfish Credit Card Business, dated March 31, 2008, among Discover Financial Services, Goldfish Bank Limited, Discover Bank, SCFC Receivables Corporation, Barclays Bank PLC, and Barclays Group US Inc. (filed as Exhibit 2.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 14, 2008 and incorporated herein by reference thereto).

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Exhibit Number	Description
2.3	Agreement and Plan of Merger by and among Discover Bank, Academy Acquisition Corp. and The Student Loan Corporation dated as of September 17, 2010 (filed as Exhibit 2.3 to Discover Financial Services' Annual Report on Form 10-K for the fiscal year ended November 30, 2010 filed on January 26, 2011 and incorporated herein by reference thereto).
3.1	Restated Certificate of Incorporation of Discover Financial Services (filed as Exhibit 3.2 to Discover Financial Services' Current Report on Form 8-K filed on May 21, 2019 and incorporated herein by reference thereto).
3.2	Amended and Restated By-Laws of Discover Financial Services (filed as Exhibit 3.3 to Discover Financial Services' Current Report on Form 8-K filed on May 21, 2019 and incorporated herein by reference thereto).
3.3	Certificate of Elimination of the Fixed Rate Cumulative Perpetual Preferred Stock, Series A, of Discover Financial Services (filed as Exhibit 3.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on June 26, 2012 and incorporated herein by reference thereto).
3.4	Certificate of Designations of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B (filed as Exhibit 3.1 to Discover Financial Services' Current Report on Form 8-K filed on October 16, 2012 and incorporated herein by reference thereto).
3.5	Certificate of Designations of Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Stock, Series C (filed as Exhibit 3.1 to Discover Financial Services' Current Report on Form 8-K filed on October 31, 2017 and incorporated herein by reference thereto).
3.6	Certificate of Elimination of Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Stock, Series B (filed as Exhibit 3.1 to Discover Financial Services' Current Report on Form 8-K filed on December 4, 2017 and incorporated herein by reference thereto).
4.1	Description of Common Stock
4.2	Senior Indenture, dated as of June 12, 2007, by and between Discover Financial Services and U.S. Bank National Association, as trustee (filed as Exhibit 4.1 to Discover Financial Services' Current Report on Form 8-K filed on June 12, 2007 and incorporated herein by reference thereto).
4.3	Subordinated Indenture, dated as of September 8, 2015, by and between Discover Financial Services and U.S. Bank National Association (filed as Exhibit 4.1 to Discover Financial Services' Current Report on Form 8-K filed on September 8, 2015 and incorporated herein by reference thereto).
4.4	Fiscal and Paying Agency Agreement, dated November 16, 2009, between Discover Bank, as issuer, and U.S. Bank National Association, as fiscal and paying agent (filed as Exhibit 4.1 to Discover Financial Services' Current Report on Form 8-K filed on November 16, 2009 and incorporated herein by reference thereto).
4.5	Fiscal and Paying Agency Agreement, dated April 15, 2010, between Discover Bank, as issuer, and U.S. Bank National Association, as fiscal and paying agent (filed as Exhibit 4.1 to Discover Financial Services' Current Report on Form 8-K filed on April 16, 2010 and incorporated herein by reference thereto).
4.6	Deposit Agreement, dated October 31, 2017 (filed as Exhibit 4.1 to Discover Financial Services' Current Report on Form 8-K filed on October 31, 2017 and incorporated herein by reference thereto).
4.7	Form of Certificate Representing the Fixed-to-Floating Rate Non-Cumulative Perpetual Preferred Stock, Series C (filed as Exhibit 4.2 to Discover Financial Services' Current Report on Form 8-K filed on October 31, 2017 and incorporated herein by reference thereto).
	<i>Other instruments defining the rights of holders of long-term debt securities of Discover Financial Services and its subsidiaries are omitted pursuant to Section (b)(4)(iii)(A) of Item 601 of Regulation S-K. Discover Financial Services agrees to furnish copies of these instruments to the SEC upon request.</i>
10.1	Tax Sharing Agreement, dated as of June 30, 2007, between Morgan Stanley and Discover Financial Services (filed as Exhibit 10.1 to Discover Financial Services' Current Report on Form 8-K filed on July 5, 2007 and incorporated herein by reference thereto).

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Exhibit Number	Description
10.2	U.S. Employee Matters Agreement, dated as of June 30, 2007, between Morgan Stanley and Discover Financial Services (filed as Exhibit 10.2 to Discover Financial Services' Current Report on Form 8-K filed on July 5, 2007 and incorporated herein by reference thereto).
10.3	Transition Services Agreement, dated as of June 30, 2007, between Morgan Stanley and Discover Financial Services (filed as Exhibit 10.3 to Discover Financial Services' Current Report on Form 8-K filed on July 5, 2007 and incorporated herein by reference thereto).
10.4	Transitional Trade Mark License Agreement, dated as of June 30, 2007, between Morgan Stanley & Co. PLC and Goldfish Bank Limited (filed as Exhibit 10.4 to Discover Financial Services' Current Report on Form 8-K filed on July 5, 2007 and incorporated herein by reference thereto).
10.5	Amended and Restated Trust Agreement, dated as of December 22, 2015, between Discover Funding LLC, as Beneficiary, and Wilmington Trust Company, as Owner Trustee (filed as Exhibit 4.6 to Discover Bank's Current Report on Form 8-K filed on December 23, 2015 and incorporated herein by reference thereto).
10.6	Third Amended and Restated Pooling and Servicing Agreement, dated as of December 22, 2015, between Discover Bank, as Master Servicer and Servicer, Discover Funding LLC, as Transferor, and U.S. Bank National Association, as Trustee (filed as Exhibit 4.2 to Discover Bank's Current Report on Form 8-K filed on December 23, 2015 and incorporated herein by reference thereto).
10.7	Amended and Restated Series Supplement for Series 2007-CC, dated as of December 22, 2015, among Discover Bank, as Master Servicer and Servicer, Discover Funding LLC, as Transferor, and U.S. Bank National Association, as Trustee (filed as Exhibit 4.3 to Discover Bank's Current Report on Form 8-K filed on December 23, 2015 and incorporated herein by reference thereto).
10.8†	Discover Financial Services Omnibus Incentive Plan (filed as an attachment to Discover Financial Services' Proxy Statement on Schedule 14A filed on February 27, 2009 and incorporated herein by reference thereto).
10.9†	Amended Form of Restricted Stock Unit Award Under Discover Financial Services Omnibus Incentive Plan (filed as Exhibit 10.6 to Discover Financial Services' Quarterly Report on Form 10-Q filed on July 12, 2007 and incorporated herein by reference thereto).
10.10†	Directors' Compensation Plan of Discover Financial Services (filed as Exhibit 10.3 to Discover Financial Services' Current Report on Form 8-K filed on June 19, 2007 and incorporated herein by reference thereto), as amended and restated as of January 20, 2011 (filed as Exhibit A to the Discover Financial Services' definitive proxy statement filed on February 18, 2011 and incorporated herein by reference thereto), as further amended by Amendment No. 2, effective as of December 1, 2011 (filed as Exhibit 10.10 to the Discover Financial Services' Annual Report on Form 10-K filed on January 26, 2012 and incorporated herein by reference thereto).
10.11†	Amended Form of Restricted Stock Unit Award Under Discover Financial Services Directors' Compensation Plan (filed as Exhibit 10.7 to Discover Financial Services' Quarterly Report on Form 10-Q filed on July 12, 2007 and incorporated herein by reference thereto).
10.12†	Discover Financial Services Employee Stock Purchase Plan (filed as Exhibit 10.2 to Discover Financial Services' Current Report on Form 8-K filed on June 19, 2007 and incorporated herein by reference thereto) as amended by Amendment No. 1 to Discover Financial Services Employee Stock Purchase Plan effective as of May 1, 2008 (filed as Exhibit 10.12 to Discover Financial Services' Annual Report on Form 10-K filed on January 28, 2009 and incorporated herein by reference thereto); Amendment No. 2 to Discover Financial Services Employee Stock Purchase Plan, effective as of December 1, 2009 (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 9, 2010 and incorporated herein by reference thereto); and Amendment No. 3 to Discover Financial Services Employee Stock Purchase Plan (filed as Exhibit 10.3 to Discover Financial Services' Quarterly Report on Form 10-Q filed on September 28, 2011 and incorporated herein by reference thereto).
10.13†	Offer of Employment, dated as of January 8, 1999 (filed as Exhibit 10.2 to Discover Financial Services' Current Report on Form 8-K filed on June 12, 2007 and incorporated herein by reference thereto).
10.14†	Waiver of Change of Control Benefits, dated September 24, 2007 (filed as Exhibit 10.15 to Discover Financial Services' Registration Statement on Form S-4 filed on November 27, 2007 and incorporated herein by reference thereto).

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Exhibit Number	Description
10.15	Collateral Certificate Transfer Agreement, dated as of July 26, 2007 between Discover Bank, as Depositor and Discover Card Execution Note Trust (filed as Exhibit 4.4 to Discover Bank's Current Report on Form 8-K filed on July 27, 2007 and incorporated herein by reference thereto).
10.16	Amended and Restated Indenture, dated as of December 22, 2015, between Discover Card Execution Note Trust, as Issuer, and U.S. Bank National Association, as Indenture Trustee (filed as Exhibit 4.4 to Discover Bank's Current Report on Form 8-K filed on December 23, 2015 and incorporated herein by reference thereto).
10.17	Second Amended and Restated Indenture Supplement for the DiscoverSeries Notes, dated as of December 22, 2015, between Discover Card Execution Note Trust, as Issuer, and U.S. Bank National Association, as Indenture Trustee (filed as Exhibit 4.5 to Discover Bank's Current Report on Form 8-K filed on December 23, 2015 and incorporated herein by reference thereto).
10.18	Omnibus Amendment to Indenture Supplement and Terms Documents, dated as of July 2, 2009, between Discover Card Execution Note Trust, as Issuer, and U.S. Bank National Association, as Indenture Trustee (filed as Exhibit 4.1 to Discover Bank's Current Report on Form 8-K filed on July 6, 2009 and incorporated herein by reference thereto).
10.19 †	Discover Financial Services Change-in-Control Severance Policy Amended and Restated October 15, 2014 (filed as Exhibit 10.1 to Discover Financial Services' Current Report on Form 8-K filed on October 16, 2014 and incorporated herein by reference thereto).
10.20	Release and Settlement Agreement, executed as of October 27, 2008, by and among Discover Financial Services, DFS Services, LLC, Discover Bank, and their Subsidiaries and Affiliates; MasterCard Incorporated and MasterCard International Incorporated and their Affiliates; and Visa Inc. and its Affiliates and Predecessors including Visa U.S.A. Inc. and Visa International Service Association (filed as Exhibit 99.1 to Discover Financial Services' Current Report on Form 8-K filed on October 28, 2008 and incorporated herein by reference thereto).
10.21 †	2008 Year End Form of Restricted Stock Unit Award Under Discover Financial Services Omnibus Incentive Plan (filed as Exhibit 10.21 to Discover Financial Services' Annual Report on Form 10-K filed on January 28, 2009 and incorporated herein by reference thereto).
10.22 †	2008 Special Grant Form of Restricted Stock Unit Award Under Discover Financial Services Omnibus Incentive Plan (filed as Exhibit 10.22 to Discover Financial Services' Annual Report on Form 10-K filed on January 28, 2009 and incorporated herein by reference thereto).
10.23	Form of Waiver, executed by each of Discover Financial Services' senior executive officers and certain other employees (filed as Exhibit 10.3 to Discover Financial Services' Current Report on Form 8-K filed on March 13, 2009 and incorporated herein by reference thereto).
10.24	Form of Executive Compensation Agreement, dated March 13, 2009, executed by each of Discover Financial Services' senior executive officers and certain other employees (filed as Exhibit 10.4 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 8, 2009 and incorporated herein by reference thereto).
10.25 †	Form of Share Award Agreement Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10(a) to Discover Financial Services' Current Report on Form 8-K filed on December 11, 2009 and incorporated herein by reference thereto).
10.26 †	Amendment to 2009 Year End Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan, effective December 1, 2009 (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 9, 2010 and incorporated herein by reference thereto).
10.27	Settlement Agreement and Mutual Release between Discover Financial Services and Morgan Stanley, dated February 11, 2010 (filed as Exhibit 10.1 to Discover Financial Services' Current Report on Form 8-K filed on February 12, 2010 and incorporated herein by reference thereto).
10.28	Purchase Price Adjustment Agreement by and among Citibank, N.A., The Student Loan Corporation and Discover Bank, dated September 17, 2010 (filed as Exhibit 10.32 to Discover Financial Services' Annual Report on Form 10-K filed on January 26, 2011 and incorporated herein by reference thereto).

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Exhibit Number	Description
10.29	Amendment to Purchase Price Adjustment Agreement by and among Citibank, N.A., The Student Loan Corporation and Discover Bank, dated December 30, 2010 (filed as Exhibit 10.33 to Discover Financial Services' Annual Report on Form 10-K filed on January 26, 2011 and incorporated herein by reference thereto).
10.30	Indemnification Agreement by and between Citibank, N.A. and Discover Bank, dated September 17, 2010 (filed as Exhibit 10.34 to Discover Financial Services' Annual Report on Form 10-K filed on January 26, 2011 and incorporated herein by reference thereto).
10.31	First Amendment to Indemnification Agreement by and between Citibank, N.A. and Discover Bank, dated December 30, 2010 (filed as Exhibit 10.35 to Discover Financial Services' Annual Report on Form 10-K filed on January 26, 2011 and incorporated herein by reference thereto).
10.32 †	Form Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.4 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 8, 2011 and incorporated herein by reference thereto).
10.33 †	Form Award Certificate for Performance Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.5 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 8, 2011 and incorporated herein by reference thereto).
10.34	Asset Purchase Agreement between Discover Bank and Citibank, N.A. dated August 31, 2011 (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on September 28, 2011 and incorporated herein by reference thereto).
10.35 †	Form 2012 Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 4, 2012 and incorporated herein by reference thereto).
10.36 †	Form 2012 Award Certificate for Performance Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 4, 2012 and incorporated herein by reference thereto).
10.37 †	Form 2013 Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 30, 2013 and incorporated herein by reference thereto).
10.38 †	Form 2013 Award Certificate for Performance Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 30, 2013 and incorporated herein by reference thereto).
10.39 †	Amendment No. 3 to the Directors' Compensation Plan of Discover Financial Services, effective as of July 1, 2013 (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on July 30, 2013 and incorporated herein by reference thereto).
10.40 †	Form of 2013 Special Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Current Report on Form 8-K filed on December 26, 2013 and incorporated herein by reference thereto).
10.41 †	Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as an attachment to Discover Financial Services' Proxy Statement on Schedule 14A filed on March 19, 2014 and incorporated herein by reference thereto).
10.42 †	Form 2014 Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 29, 2014 and incorporated herein by reference thereto).
10.43 †	Form 2014 Award Certificate for Performance Stock Units Under Discover Financial Services Amended and Restated 2007 Omnibus Incentive Plan (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 29, 2014 and incorporated herein by reference thereto).
10.44 †	Amendment No. 4 to the Directors' Compensation Plan of Discover Financial Services, effective as of May 7, 2014 (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on August 1, 2014 and incorporated herein by reference thereto).

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Exhibit Number	Description
10.45 †	Form 2015 Award Certificate for Cash-Converted Restricted Stock Units Under Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 30, 2015 and incorporated herein by reference thereto).
10.46 †	Form 2015 Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 30, 2015 and incorporated herein by reference thereto).
10.47 †	Form 2015 Award Certificate for Performance Stock Units Under Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as Exhibit 10.3 to Discover Financial Services' Quarterly Report on Form 10-Q filed on April 30, 2015 and incorporated herein by reference thereto).
10.48 †	Form of 2015 Special Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Current Report on Form 8-K filed on April 30, 2015 and incorporated herein by reference thereto).
10.49 †	Amendment No. 4 to Discover Financial Services Employee Stock Purchase Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on October 29, 2015 and incorporated herein by reference thereto).
10.50 †	Form of 2015 Special Award Certificate for Restricted Stock Units Under Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Current Report on Form 8-K filed on December 21, 2015 and incorporated herein by reference thereto).
10.51	Receivables Sale and Contribution Agreement, dated as of December 22, 2015 between Discover Bank and Discover Funding LLC (filed as Exhibit 4.1 to Discover Bank's Current Report on Form 8-K filed on December 23, 2015 and incorporated herein by reference thereto).
10.52 †	Form 2016 Award Certificate for Restricted Stock Units under Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as Exhibit 10.52 to Discover Financial Services' Annual Report on Form 10-K filed on February 24, 2016 and incorporated herein by reference thereto).
10.53 †	Form 2016 Award Certificate for Performance Stock Units under Discover Financial Services Amended and Restated 2014 Omnibus Incentive Plan (filed as Exhibit 10.53 to Discover Financial Services' Annual Report on Form 10-K filed on February 24, 2016 and incorporated herein by reference thereto).
10.54 †	Amendment No. 5 to Directors' Compensation Plan of Discover Financial Services, effective as of January 1, 2017 (filed as Exhibit 10.54 to Discover Financial Services' Annual Report on Form 10-K filed on February 23, 2017 and incorporated herein by reference thereto).
10.55 †	Form 2017 Award Certificate for Restricted Stock Units under Discover Financial Services Amended and Restated Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 2, 2017 and incorporated herein by reference thereto).
10.56 †	Form 2017 Award Certificate for Performance Stock Units under Discover Financial Services Amended and Restated Omnibus Incentive Plan (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 2, 2017 and incorporated herein by reference thereto).
10.57 †	Form 2018 Award Certificate for Restricted Stock Units under Discover Financial Services Director's Compensation Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 1, 2018 and incorporated herein by reference thereto).
10.58 †	Form 2018 Award Certificate for Restricted Stock Units under Discover Financial Services Amended and Restated Omnibus Incentive Plan (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 1, 2018 and incorporated herein by reference thereto).
10.59 †	Form 2018 Award Certificate for Performance Stock Units under Discover Financial Services Amended and Restated Omnibus Incentive Plan (filed as Exhibit 10.3 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 1, 2018 and incorporated herein by reference thereto).

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Exhibit Number	Description
10.60 †	Amendment to 2017 Directors' Annual Equity Award Certificate for Restricted Stock Units of Discover Financial Services, effective as of February 22, 2018 (filed as Exhibit 10.4 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 1, 2018 and incorporated herein by reference thereto).
10.61 †	Amendment No. 6 to the Directors' Compensation Plan of Discover Financial Services, effective as of February 22, 2018 (filed as Exhibit 10.5 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 1, 2018 and incorporated herein by reference thereto).
10.62 †	Amendment No. 7 to the Directors' Compensation Plan of Discover Financial Services, effective as of January 1, 2019 (filed as Exhibit 10.62 to Discover Financial Services' Annual Report on Form 10-K filed on February 20, 2019 and incorporated herein by reference thereto).
10.63 †	Amendment No. 8 to the Directors' Compensation Plan of Discover Financial Services, effective as of January 1, 2019 (filed as Exhibit 10.63 to Discover Financial Services' Annual Report on Form 10-K filed on February 20, 2019 and incorporated herein by reference thereto).
10.64 †	Form 2019 Award Certificate for Restricted Stock Units under Discover Financial Services Amended and Restated Omnibus Incentive Plan (filed as Exhibit 10.1 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 2, 2019 and incorporated herein by reference thereto).
10.65 †	Form 2019 Award Certificate for Performance Stock Units under Discover Financial Services Amended and Restated Omnibus Incentive Plan (filed as Exhibit 10.2 to Discover Financial Services' Quarterly Report on Form 10-Q filed on May 2, 2019 and incorporated herein by reference thereto).
21	Subsidiaries of the Registrant.
23	Consent of Independent Registered Public Accounting Firm.
24	Powers of Attorney (included on signature page).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.
101	Interactive Data File — the following financial statements from Discover Financial Services Annual Report on Form 10-K formatted in inline XBRL: (1) Consolidated Statements of Financial Condition, (2) Consolidated Statements of Income, (3) Consolidated Statements of Comprehensive Income, (4) Consolidated Statements of Changes in Stockholders' Equity, (5) Consolidated Statements of Cash Flows and (6) Notes to the Consolidated Financial Statements.
104	Cover Page Interactive Data File — the cover page from Discover Financial Services Annual Report on Form 10-K formatted in inline XBRL and contained in Exhibit 101.

* We agree to furnish supplementally to the Commission a copy of any omitted schedule or exhibit to such agreement upon the request of the Commission in accordance with Item 601(b)(2) of Regulation S-K.
† Management contract or compensatory plan or arrangement required to be filed as an exhibit to Form 10-K pursuant to Item 15(b) of this report.

Item 16. Form 10-K Summary

None.

Signature

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Discover Financial Services
(Registrant)

By: _____ /s/ JOHN T. GREENE

John T. Greene
Executive Vice President, Chief Financial Officer

Date: February 26, 2020

Power of Attorney

We, the undersigned, hereby severally constitute Wanjiku J. Walcott and D. Christopher Greene, and each of them singly, our true and lawful attorneys with full power to them and each of them to sign for us, and in our names in the capacities indicated below, any and all amendments to the annual report on Form 10-K filed with the Securities and Exchange Commission, hereby ratifying and confirming our signatures as they may be signed by our said attorneys to any and all amendments to said Annual Report on Form 10-K.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on February 26, 2020.

Signature	Title
<u>/s/ ROGER C. HOCHSCHILD</u> Roger C. Hochschild	Chief Executive Officer and President, Director
<u>/s/ JOHN T. GREENE</u> John T. Greene	Executive Vice President, Chief Financial Officer (Principal Financial Officer)
<u>/s/ EDWARD W. MCGROGAN</u> Edward W. McGrogan	Senior Vice President and Chief Accounting Officer (Principal Accounting Officer)
<u>/s/ LAWRENCE A. WEINBACH</u> Lawrence A. Weinbach	Chairman of the Board
<u>/s/ JEFFREY S. ARONIN</u> Jeffrey S. Aronin	Director
<u>/s/ MARY K. BUSH</u> Mary K. Bush	Director
<u>/s/ GREGORY C. CASE</u> Gregory C. Case	Director
<u>/s/ CANDACE H. DUNCAN</u> Candace H. Duncan	Director
<u>/s/ JOSEPH F. EAZOR</u> Joseph F. Eazor	Director
<u>/s/ CYNTHIA A. GLASSMAN</u> Cynthia A. Glassman	Director
<u>/s/ THOMAS G. MAHERAS</u> Thomas G. Maheras	Director
<u>/s/ MICHAEL H. MOSKOW</u> Michael H. Moskow	Director
<u>/s/ MARK A. THIERER</u> Mark A. Thierer	Director
<u>/s/ JENNIFER L. WONG</u> Jennifer L. Wong	Director

DESCRIPTION OF SECURITIES
REGISTERED PURSUANT TO SECTION 12 OF
THE SECURITIES EXCHANGE ACT OF 1934

The following summary describes our common stock, par value \$0.01 per share, of Discover Financial Services, which is the only security of the Company registered pursuant to Section 12 of the Securities Exchange Act of 1934. In this summary, the terms “we” and “our” refer to Discover Financial Services and its consolidated subsidiaries, unless the context requires otherwise.

DESCRIPTION OF COMMON STOCK

The summary describes the material terms of our common stock and is not complete. This summary is qualified in its entirety by reference to applicable Delaware law, our amended and restated certificate of incorporation (our “Certificate of Incorporation”) and our amended and restated bylaws (our “Bylaws”). For a complete description of our common stock, we refer you to our Certificate of Incorporation and Bylaws, which have been filed with the Securities and Exchange Commission and are incorporated by reference as exhibits to this Annual Report on Form 10-K.

Authorized Capitalization

Our authorized common stock consists of 2,000,000,000 shares of common stock, par value \$0.01 per share, and 200,000,000 shares of preferred stock, par value \$0.01 per share. The preferred stock is issuable in one or more series, with rights, preferences, and privileges as established by the Board of Directors of the Company without stockholder approval, including voting, dividend, redemption, liquidation, conversion and other rights. As of December 31, 2019, 310,157,158 shares of our common stock were outstanding and 5,700 shares of our preferred stock, consisting of our Series C Preferred Stock, were outstanding.

Description of Common Stock

General. The rights, preferences and privileges of holders of our common stock are subject to, and may be adversely affected by, the rights of the holders of shares of any series of our preferred stock.

Voting Rights. The holders of our common stock are entitled to one vote per share on all matters to be voted on by stockholders. Holders of common stock have the exclusive right to vote for the election of directors and for all other purposes. Holders of shares of common stock are not entitled to cumulate their votes in the election of directors. Generally, all matters to be voted on by stockholders must be approved by a majority of the votes entitled to be cast by the holders of common stock present in person or represented by proxy, voting together as a single class, subject to any voting rights granted to holders of any preferred stock.

Dividend Rights. Holders of common stock will share equally on a pro rata basis in any dividends as may be declared by our board of directors out of funds legally available for that purpose, subject to any preferential rights of holders of any outstanding shares of preferred stock and any other class or series of stock having preference over the common stock as to dividends.

Preemptive Rights. No shares of common stock are subject to redemption or have preemptive rights to purchase additional shares of common stock or other securities of our company. There are no other subscription rights or conversion rights, and there are no sinking fund provisions applicable to our common stock.

Other Rights. Upon voluntary or involuntary liquidation, dissolution or winding up of our company, after payment in full of the amounts required to be paid to creditors and holders of any preferred stock that may be then outstanding, all holders of common stock are entitled to share equally on a pro rata basis in all remaining assets.

Listing. Our shares of common stock are listed on the New York Stock Exchange under the ticker “DFS.”

Transfer Agent and Registrar. The transfer agent and registrar for our common stock is Computershare.

Anti-Takeover Effects of Our Amended and Restated Certificate of Incorporation and Bylaws, Delaware Law and Federal Banking Law

Some provisions of Delaware law and our Certificate of Incorporation and Bylaws could make the following more difficult:

- acquisition of us by means of a tender offer or merger;
- acquisition of us by means of a proxy contest or otherwise; or
- removal of our incumbent officers and directors.

These provisions, summarized below, are expected to discourage coercive takeover practices and inadequate takeover bids. These provisions also are designed to encourage persons seeking to acquire control of us to first negotiate with our board of directors. We believe that the benefits of the potential ability to negotiate with the proponent of an unfriendly or unsolicited proposal to acquire or restructure our company outweigh the disadvantages of discouraging those proposals because negotiation of them could result in an improvement of their terms.

Stockholder Action by Written Consent. Subject to the rights of holders of any series of preferred stock or any other series or class of stock, any action required or permitted to be taken by our stockholders must be effected at a duly called annual or special meeting of stockholders and may not be effected by any consent in writing in lieu of a meeting.

Amendments to our Governing Documents. The amendment of any provision of our Certificate of Incorporation requires approval by our board of directors and a majority vote of stockholders. Any amendment to our bylaws requires the approval of either a majority of our board of directors or holders of a majority of the votes entitled to be cast by the outstanding capital stock in the election of our board of directors.

Stockholder Meetings. Our Bylaws provide that, subject to the rights of holders of any series of preferred stock or any other series or class of stock as set forth in our Certificate of Incorporation, special meetings of our stockholders may be called only by our secretary at the direction of and pursuant to a resolution of our board of directors or at the written request of stockholders who have, or who are acting on behalf of beneficial owners who have, an aggregate "net long position" of at least 25% of the common stock as of the ownership record date and who otherwise comply with the requirements of these bylaws; provided that each such stockholder, or beneficial owner directing such stockholder, must have held such "net long position" included in such aggregate amount continuously for the one-year period ending on the ownership record date and must continue to hold such "net long position" through the date of the conclusion of the special meeting.

Requirements for Advance Notification of Stockholder Nominations and Proposals. Our Bylaws establish advance notice procedures with respect to stockholder proposals and nomination of candidates for election as directors.

Delaware Anti-Takeover Law. Our Certificate of Incorporation does not exempt us from the application of Section 203 of the Delaware General Corporation Law, an anti-takeover law.

In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder for a period of three years following the date the person became an interested stockholder, unless the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Generally, a "business combination" includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. Generally, an "interested stockholder" is a person that, together with affiliates and associates, owns, or within three years prior to the determination of interested stockholder status, did own, 15% or more of a corporation's voting stock. This may have an anti-takeover effect with respect to transactions not approved in advance by our board of directors, including discouraging attempts that might result in a premium over the market price for the shares of our common stock.

No Cumulative Voting. Our amended and restated certificate of incorporation and bylaws do not provide for cumulative voting in the election of directors.

Undesignated Preferred Stock. The authorization of our undesignated preferred stock makes it possible for our board of directors to issue our preferred stock with voting or other rights or preferences that could impede the success of any attempt to change control of us. These and other provisions may have the effect of deferring hostile takeovers or delaying changes of control of our management.

Federal Banking Law. The Change in Bank Control Act of 1978, as amended, prohibits a person or group of persons from acquiring “control” of a bank holding company unless:

- the Federal Reserve has been given 60 days’ prior written notice of such proposed acquisition containing the information requested by the Federal Reserve; and
- within that time period the Federal Reserve has not issued a notice disapproving the proposed acquisition or extending the period during which such a disapproval may be issued.

An acquisition may be made prior to the expiration of the disapproval period if the Federal Reserve issues written notice of its intent not to disapprove the action. An acquirer is conclusively deemed to have acquired control if it owns, controls, or has the power to vote 25 percent or more of a class of voting securities. In addition, under a rebuttable presumption established by the Federal Reserve, the acquisition of 10% or more of a class of voting securities of a bank holding company with securities registered under Section 12 of the Exchange Act, such as us, would be presumed to constitute the acquisition of control. In addition, any “company” would be required to obtain the approval of the Federal Reserve under the Bank Holding Company Act of 1956, as amended, before acquiring 25% (5% in the case of an acquiror that is, or is deemed to be, a bank holding company) or more of any class of voting securities, or a lesser number of shares if the acquirer otherwise is deemed to have control over us by the Federal Reserve, and may be subject to ongoing regulation and supervision as a bank holding company.

**DISCOVER FINANCIAL SERVICES
SUBSIDIARIES**

Subsidiary	Jurisdiction of Incorporation or Formation
Bank of New Castle	Delaware
DFS Corporate Services LLC	Delaware
DFS GSD Corp. (d/b/a Discover Payment Solutions)	Arizona
DFS International Inc.	Delaware
DFS Services LLC	Delaware
Diners Club International Ltd.	New York
Diners Club Services Private Limited	India
Diners Club Taiwan Ltd.	Taiwan
Discover Bank	Delaware
Discover Financial Services (Canada), Inc.	Canada
Discover Financial Services (Hong Kong) Limited	Hong Kong
Discover Financial Services (UK) Limited	England/Wales
Discover Funding LLC	Delaware
Discover Global Employment Company Private Limited	Singapore
Discover Home Loans, Inc.	Delaware
Discover Information Technology (Shanghai) Limited	Shanghai
Discover Products Inc.	Utah
Discover Properties LLC	Delaware
Discover Services Corporation	Delaware
GTC Insurance Agency, Inc.	Delaware
PULSE Network LLC	Delaware
The Student Loan Corporation	Delaware

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 333-173360, 333-150228, 333-144184, 333-144188, and 333-144189 on Form S-8 and No. 333-225830 on Form S-3 of our reports dated February 26, 2020, relating to the consolidated financial statements of Discover Financial Services, and the effectiveness of Discover Financial Services' internal control over financial reporting, appearing in this Annual Report on Form 10-K of Discover Financial Services for the year ended December 31, 2019.

/s/ DELOITTE & TOUCHE LLP

Chicago, Illinois

February 26, 2020

CERTIFICATION

I, Roger C. Hochschild, certify that:

1. I have reviewed this Annual Report on Form 10-K of Discover Financial Services (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2020

/s/ ROGER C. HOCHSCHILD

Roger C. Hochschild

Chief Executive Officer and President

CERTIFICATION

I, John T. Greene, certify that:

1. I have reviewed this Annual Report on Form 10-K of Discover Financial Services (the "registrant");
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2020

/s/ JOHN T. GREENE

John T. Greene

Executive Vice President, Chief Financial
Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Discover Financial Services (the "Company") on Form 10-K for the period ended December 31, 2019, as filed with the Securities and Exchange Commission (the "Report"), each of Roger C. Hochschild, Chief Executive Officer and President of the Company, and John T. Greene, Executive Vice President and Chief Financial Officer of the Company, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 26, 2020

/s/ ROGER C. HOCHSCHILD

Roger C. Hochschild

Chief Executive Officer and President

Date: February 26, 2020

/s/ JOHN T. GREENE

John T. Greene

Executive Vice President, Chief Financial
Officer