Discover Financial Services
Form 10-K
February 25, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the calendar year ended December 31, 2013

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

Commission File Number 001-33378

DISCOVER FINANCIAL SERVICES
(Exact name of registrant as specified in its charter)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01 per share	New York Stock Exchange
Depositary Shares, each representing 1/40th interest in a share of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series B, par value $0.01 per share	New York Stock Exchange

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

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

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 o No S

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. S

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

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

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

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 $22,996,337,070.

As of February 14, 2014, there were 470,895,643 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 7, 2014 are incorporated by reference in Part III of this Form 10-K.

DISCOVER FINANCIAL SERVICES
Annual Report on Form 10-K for the calendar year ended December 31, 2013

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Except as otherwise indicated or unless the context otherwise requires, “Discover Financial Services,” “Discover,” “DFS,” “we,” “us,” “our,” and “the Company” refer to Discover Financial Services and its subsidiaries.
We own or have rights to use the trademarks, trade names and service marks that we use in conjunction with the operation of our business, including, but not limited to: Discover®, PULSE®, Cashback Bonus®, Discover Cashback Checking℠, Discover® More® Card, Discover it®, Discover® Motiva℠ Card, Discover® Open Road® Card, Discover® Network and Diners Club International®. All other trademarks, trade names and service marks included in this annual report on Form 10-K are the property of their respective owners.

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Part I.
Item 1. Business
Introduction
Discover Financial Services is a 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”). Through our Discover Bank subsidiary, a Delaware state-chartered bank, we offer our customers credit card loans, private student loans, personal loans, home equity loans and deposit products. Through our Discover Home Loans, Inc. subsidiary, we offer our customers home loans. We had $65.8 billion in loan receivables and $28.4 billion in deposits issued through direct-to-consumer channels and affinity relationships at December 31, 2013. Through our DFS Services LLC subsidiary and its subsidiaries, we operate the Discover Network, the PULSE network (“PULSE”), and Diners Club International (“Diners Club”). The Discover Network is a payment card transaction processing network for Discover-branded credit cards and credit, debit and prepaid cards issued by third parties, which we refer to as network partners. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE network with access to ATMs domestically and internationally, as well as point-of-sale ("POS") terminals at retail locations throughout the U.S. for debit card transactions. Diners Club is a global payments network of licensees that issue Diners Club branded charge cards and/or provide card acceptance services.
In December 2012, our board of directors approved a change in our fiscal year end from November 30 to December 31 of each year. This fiscal year change was effective January 1, 2013. As a result of the change, we had a one month transition period in December 2012. The audited results for the one month ended December 31, 2012 and the unaudited results for the one month ended December 31, 2011 are included in this report. For further information regarding the one month as of and ended December 31, 2012 and 2011, see Note 26: Transition Period Financial Information to our consolidated financial statements.
Available Information
We make available, free of charge through the investor relations page of our internet site www.discoverfinancial.com, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, Forms 3, 4 and 5 filed by or on behalf of directors 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 and Risk, Compensation and Leadership Development, and Nominating and Governance 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 and small businesses on the Discover Network and other consumer banking products and services, including private student loans, personal loans, home loans, home equity loans, prepaid cards and other consumer lending and deposit products. Our Payment Services segment includes PULSE, Diners Club and our network partners business, which includes credit, debit and prepaid cards issued on the Discover Network by third parties.
We are principally engaged in providing products and services to customers in the United States, although the royalty and licensee revenue we receive from Diners Club licensees is mainly derived from sources outside of the United States. For quantitative information concerning our geographic distribution, see Note 5: Loan Receivables to our consolidated financial statements, and for quantitative information concerning our royalty revenue, see Note 15: Other Income and Other Expense to our consolidated financial statements.

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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 23: Segment Disclosures to our consolidated financial statements.

Direct Banking

Set forth below are descriptions of our credit cards, student loans, personal loans, home loans, home equity loans and deposit products. For additional information regarding the terms and conditions of these products, see "— Product Terms and Conditions."

Credit Cards

We offer credit cards to consumers and small businesses. Our credit card customers are permitted to "revolve" their balances and repay their obligations over a period of time and at an interest rate set forth in their cardmember agreements, which may be either fixed or variable. The interest that we earn on revolving credit card balances makes up approximately 85% 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, balance transfer transactions and cash advance transactions.

Our credit card customers' transactions in the U.S. are processed over the Discover Network. Where we have a direct relationship with a merchant, which is the case with respect to our large merchants representing a majority of Discover card sales volume, we receive discount and fee revenue from merchants. Discount and fee revenue is based on pricing that is set forth in contractual agreements with each such merchant and is based on a number of factors including industry practices, special marketing arrangements, competitive pricing levels and merchant size. Where we do not have a direct relationship with a merchant, we receive acquirer interchange and assessment fees from the merchant acquirer that settles transactions with the merchant. The amount of this fee is based on a standardized schedule and can vary based on the type of merchant or type of card (e.g., consumer or business).

Most of our cards offer the Cashback Bonus rewards program, the costs of which we record as a reduction of discount and interchange revenue. 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:

Student Loans

Our private student loans are available to students attending eligible non-profit four-year undergraduate and graduate schools. We also offer certain post-graduate loans, including bar study and residency loans. We encourage students to borrow responsibly and maximize grants, scholarships and other free financial aid before taking student loans.

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We currently offer fixed and variable rate private student loans originated by Discover Bank. We market our student loans online and through direct mail and e-mail to existing and potential customers. We also work with school financial aid offices to create awareness of our products with students. Students can apply for our student loans online, by phone, or by mail, and we have dedicated staff within our call centers to service student loans. All applicants are encouraged to apply with a creditworthy cosigner, which may improve the likelihood for loan approval and a lower interest rate.

As part of the loan approval process, all of our student loans, except for bar study and residency loans, are certified and disbursed through the school to ensure students do not borrow more than the cost of attendance. Upon graduation, students with variable rate loans are generally eligible to receive a graduation reward. Students may redeem their graduation reward as a credit to the balance of any of their Discover student loans or as a direct deposit to a bank account.

Personal Loans

Our personal loans are unsecured loans with fixed interest rates, terms and payments. These loans are primarily intended to help customers consolidate existing debt, although they can be used for other reasons. We generally market personal loans to our existing credit card customers through direct mail, statement inserts and email. We also market personal loans to non-Discover customers through direct mail. Customers can submit applications via phone, online or through the mail, and can service their accounts online or by phone.

Home Loans and Home Equity Loans

In 2012, we began offering home mortgage loans and related services to help consumers finance home purchases and refinance existing home mortgages. We offer prime variable, fixed-rate conforming, jumbo and Federal Housing Administration ("FHA") loans to qualified applicants. We generally market home loans to existing Discover customers through direct mail, e-mail, statement envelopes and inserts, and advertising on Discover websites. We also market home loans to non-Discover customers through direct mail, internet advertising, including search engine marketing, display banners, internet lead aggregators, rate tables on financial websites, and social media. Consumers can apply for or obtain information about home loans by mail or online, or they can speak directly to a dedicated mortgage banker over the phone. Loans are funded and closed using proceeds principally from borrowings under a third-party warehouse line of credit. Substantially all funded loans and the related loan servicing rights are sold to investors in the secondary market, generally within 30 days of funding. The proceeds from such sales are used to repay borrowings under the warehouse line of credit. In addition to funding loans, we offer escrow and title services to home loan customers. For more information regarding our warehouse line of credit, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Funding Sources — Short-Term Borrowings."

We offer home equity loans to help consumers improve their homes as well as payoff higher interest debt. These loans are fixed term and rate loans that provide consumers the stability of a fixed payment on their obligation while being secured against the equity in their homes. We market this product primarily to existing card customers through a mix of direct mail, internet advertising and email. Non-Discover customers can obtain information regarding Discover home equity products from the internet banner ads on our website and have the ability to apply by calling a personal banker.

Deposits

We obtain deposits from consumers directly or through affinity relationships ("direct-to-consumer deposits") and through third-party securities brokerage firms that offer our deposits to their customers ("brokered deposits"). Our deposit products include certificates of deposit, money market accounts, savings accounts, checking accounts and Individual Retirement Account ("IRA") certificates of deposit. We market our direct-to-consumer deposit products to our existing customer base and other prospective customers through the use of our website, mobile platform, print materials, affinity arrangements with third parties and internet advertising. Customers can apply for, fund, and service their deposit accounts online or via phone, where we have a dedicated staff within our call centers to service deposit accounts. 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 includes credit, debit and prepaid cards issued on the Discover Network by third parties.

PULSE Network

Our PULSE network is one of the nation’s leading ATM/debit networks. PULSE links cardholders of approximately 6,000 financial institutions with ATMs and POS terminals located throughout the United States. This includes approximately 4,000 financial institutions with which PULSE has direct relationships and approximately 2,000 additional financial institutions through agreements PULSE has with other debit networks. PULSE also provides cash access at 1.3 million ATMs in over 120 countries.

PULSE's primary source of revenue is transaction fees charged for switching and settling ATM, personal identification number ("PIN") POS debit and signature debit transactions initiated through the use of debit cards issued by participating financial institutions. In addition, PULSE offers a variety of optional products and services that produce income for the network, including signature debit 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 PIN 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 PIN POS and ATM debit service. A participating financial institution assumes liability for transactions initiated through the use of debit cards issued by that institution, as well as for ensuring compliance with PULSE's operating rules and policies applicable to that institution's debit cards, ATMs and, if applicable, sponsored merchants, direct processors and independent sales organizations.

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 an acceptance network in over 185 countries and territories through its relationships with over 80 licensees, which are generally financial institutions. We generally 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 internet 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 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 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 network domestically and internationally.

Network Partners Business

We have agreements related to issuing credit, debit and prepaid cards with a number of other financial institutions or networks for issuance of card products accepted on Discover networks. We refer to these financial institutions or networks as "network partners". We may earn merchant discount or acquirer assessment and fees, net of issuer fees paid, for transactions for network partners who issue cards accepted on Discover networks.

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The following chart* shows the network partner transaction cycle:
* * *
The discussion below provides additional detail concerning the supporting functions of our two segments. The credit card, student loan, personal loan, home loan, home equity loan and deposit products issued through our Direct Banking segment require significant consumer portfolio investments in 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 risk primarily according to 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 our marketing efforts, including direct mail, internet, media advertising and merchant or partner relationships, or through unsolicited individual applications. We also acquire new student loan, personal loan and home loan customers through similar targeted marketing efforts, although student and home loan customers may also submit unsolicited individual applications. In all cases, we believe that we have a rigorous process for screening applicants.

To identify credit-worthy prospective customers, our credit risk management team uses proprietary targeting and analytical tools and our marketing team matches output from them with our product offerings. We consider the prospective customer's financial stability, as well as ability and willingness to pay. In order to make the best use of our resources to acquire new accounts, we seek production efficiencies, conduct testing, and aim to continuously improve our product offerings and enhance our targeting and analytical models.

We assess the creditworthiness of each consumer loan applicant through our underwriting process. We evaluate prospective customers' applications using credit information provided by the credit bureaus and other sources. We use credit scoring systems, both externally developed and proprietary, to evaluate consumer and credit bureau data. For our unsecured lending products, we also use experienced credit underwriters to supplement our automated decision-making processes. For our home loan and home equity products, experienced credit underwriters must review and approve each application.

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Upon approval of a customer's application for one of our unsecured lending and home equity products, we assign a specific annual percentage rate ("APR") using an analytical pricing strategy that provides competitive pricing for customers and seeks to maximize revenue on a risk-adjusted basis. For our credit card loans, we also assign a revolving 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 reflects information relating to the performance of the individual's Discover account as well as information from credit bureaus relating to the customer's broader credit performance. We utilize 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 limits on transaction authorization and increases or decreases in purchase and cash credit limits. Our installment loans are billed according to an amortization schedule that is calculated at the time of the disbursement of the loan and, in the case of student loans, at the time the loan enters repayment.

Customer Assistance

We provide our customers with a variety of tools to proactively manage their accounts, including electronic payment 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 becoming current 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 initiates contact with customers within 30 days after any portion of their balance becomes past due. The nature and the timing of the initial contact, typically a personal call or letter, are determined by a review of the customer's prior account activity and payment habits.

We re-evaluate our collection efforts and consider the implementation of other techniques, including internal collection activities and use of external vendors, 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 becoming current on their obligations to us. For more information see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Loan Quality — Modified and Restructured Loans."

Marketing

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

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 mail, phone and online. Targeted marketing efforts may include balance transfer offers and reinforcement of our Cashback Bonus 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 have been able to improve our modeling and customer engagement capabilities, which helps optimize product, pricing and channel selection.

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Rewards / Cashback Bonus

Our cardmembers use several card products that allow them to earn their rewards based on how they want to use credit, as set forth below.

- Discover it card offers 5% Cashback Bonus in categories that change throughout the year up to a quarterly maximum (signing up is required) and 1% Cashback Bonus on all other purchases, as well as other benefits.
- Discover More card offers 5% Cashback Bonus in categories that change throughout the year up to a quarterly maximum (signing up is required) and up to 1% Cashback Bonus* on all other purchases.
- Discover Open Road card offers 2% Cashback Bonus on the first $250 spent in combined gas and restaurant purchases each billing period and up to 1% Cashback Bonus* on all other purchases.
- Discover Motiva card provides customers with Cashback Bonus equal to 5% of their interest charges each month for making on-time payments and up to 1% Cashback Bonus* on all purchases.
- Miles by Discover customers receive two miles for every $1 on the first $3,000 spent in travel and restaurant purchases each year, one mile for every $1 spent thereafter, and one mile for every $1 spent on all other purchases.
- Escape by Discover customers receive two miles for every $1 on all purchases. This card has a $60 annual fee.
- Discover Business card offers 5% Cashback Bonus on the first $2,000 spent in office supply purchases, 2% Cashback Bonus on the first $2,000 spent in gas purchases each year and up to 1% Cashback Bonus** on all other purchases.

* Up to 1% Cashback Bonus is based upon a customer's spending level and type of purchase. Customers earn .25% on their first $3,000 in qualifying purchases and on all purchases made at select warehouse clubs, wholesale distributors, discount stores and their affiliates. Customers earn 1% once their total qualified annual purchases exceed $3,000.

** Up to 1% Cashback Bonus is based upon a customer’s spending level and type of purchase. Customers earn .25% on their first $5,000 in qualifying purchases on all purchases made at select warehouse clubs, wholesale distributors, discount stores and their affiliates. Customers earn 1% on their total qualified annual purchases exceeding $5,000.

Customers can earn 5-20% Cashback Bonus at over 200 online retailers when they shop using their Discover card through our exclusive online shopping portal, ShopDiscover. Customers who are not delinquent or otherwise disqualified may pay with Cashback Bonus by redeeming instantly at select retailers in any dollar amount. They can also redeem their Cashback Bonus for (i) merchant partner gift cards (starting at $20) that add $5 or more to their reward; (ii) Discover gift cards (starting at $20); or (iii) charitable donations to select charities (starting at $20). Cashback Bonus can be redeemed (starting at and in increments of $50) in the form of a statement credit or direct deposit to a bank account.

Miles by Discover customers earn double miles for their purchases made at retailers through ShopDiscover. Escape by Discover customers earn 4 miles for every $1 spent at retailers through ShopDiscover. Miles by Discover customers who are not delinquent or otherwise disqualified may pay with miles by redeeming instantly for select retailers in any amount. Miles can also be redeemed for brand-name merchandise with free shipping starting at 2,000 miles, travel credits starting at 10,000 miles, partner gift cards starting at 1,000 miles, Discover gift cards starting at 5,000 miles, cash in the form of statement credits or direct deposit to a bank account starting at 5,000 miles, or charitable donations starting at 5,000 miles.

Protection Products

We currently service and maintain existing enrollments in the following protection products for our credit card customers. Although we suspended new sales of these products to consumers at the end of 2012, we may resume offering similar products in the future.

- Identity Theft Protection. The most comprehensive identity theft monitoring product we offer 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 up to 20 credit and debit card numbers on suspicious websites, identity theft insurance up to $25,000 to cover certain out-of-pocket expenses due to identity theft, and access to knowledgeable professionals who can provide information about identity theft issues.

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- Payment Protection. This product allows customers to suspend their payments for up to two years, depending on the qualifying event and product level, when certain hardships 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 and availability under state laws, outstanding balances up to $10,000 or $25,000, depending on product level 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, providing up to $100 to replace the customer's wallet or purse and, if needed, allowing the customer up to a $1,000 cash advance on his or her Discover card account.
- Credit ScoreTracker. This product offers customers resources that help them understand and monitor their credit scores. Credit ScoreTracker is specifically designed for score monitoring by alerting customers when their score changes, allowing customers to set a target score, and providing resources to help customers understand the factors that may be influencing their scores.

In addition to the protection products above, our credit card customers can purchase online service warranties from our extended warranty provider to protect purchases of new electronics and appliances as well as certain other purchases.

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. 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 customers can contact our customer service personnel by calling 1-800-Discover. Credit card customers can also manage their accounts online or through applications for certain mobile devices. Our internet and mobile solutions offer a range of benefits, including:

- Online account services that allow customers to customize their accounts, choose how and when they pay their bills, view annual account summaries that assist them with budgeting and taxes, research transaction details, initiate transaction disputes, and chat with or email a customer representative;
- Email and mobile text reminders that help customers avoid fees, keep their accounts secure and track big purchases or returns;
- Money management tools like the Spend Analyzer, Paydown Planner and Purchase Planner; and
- An online portal where customers automatically earn 5-20% Cashback Bonus when they shop at well-known online merchants using their Discover card.

Our student loan, personal loan, home equity and deposit product customers can utilize our online account services to manage their accounts, and to use interactive tools and calculators. For the home loan origination process, we have an online portal for home loan customers to educate themselves on the home loan process, monitor the status of their loans prior to funding, upload documents, and e-sign initial loan documents.

Processing Services

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

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Fraud Prevention

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

Each credit card transaction is subject to screening, authorization and approval through a proprietary POS decision system. 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.

Product Terms and Conditions

Credit Cards

The terms and conditions governing our credit card products vary by product and change over time. Each credit card customer enters into a cardmember agreement governing the terms and conditions of the customer's account. Discover card's terms and conditions are generally uniform from state to state. The cardmember agreement permits us, to the extent permitted by law, to change any term of the cardmember agreement, including any finance charge, rate or fee, or add or delete any term of the cardmember agreement, with notice to the customer as required by law. The customer has the right to opt out of certain changes of terms and pay their balance off under the unchanged terms. Each cardmember agreement provides that the account can be used for purchases, cash advances and balance transfers.

Each Discover card account is assigned a credit limit when the account is initially opened. Thereafter, individual credit limits may be increased or decreased from time to time, at our discretion, based primarily on our evaluation of the customer's creditworthiness. We offer various features and services with the Discover card accounts, including the Cashback Bonus rewards programs described under "— Marketing — Rewards/Cashback Bonus."

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

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

Each customer with an outstanding debit balance on his or her Discover card account must generally make a minimum payment each month. If a customer exceeds his or her credit limit as of the last day of the billing period, we may include all or a portion of this excess amount in the customer's minimum monthly payment. A customer may pay the total amount due at any time. We also may enter into arrangements with delinquent customers to extend or otherwise change payment schedules, and to waive finance charges and/or fees, including re-aging accounts in accordance with regulatory guidance.

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

The Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "CARD Act") required us, beginning February 2011, to review, every six months, certain interest rates that were increased on accounts since January 1, 2009 to determine whether to reduce the interest rate based on the factors that prompted the increase or factors we currently consider in determining interest rates applicable to similar new credit card accounts. The amount of any rate decrease must be determined based upon our reasonable policies and procedures. Any reduced interest rate must be applied to the account not later than 45 days after completion of the review.

Student Loans

The terms and conditions governing our student loans vary by product and are specified in the borrower's promissory note and disclosures. Each borrower signs a promissory note and separately accepts the loan terms during the application process. Student loans feature zero origination fees, fixed or variable interest rates, and a 2% graduation reward for variable rate loans. Student loans have a deferment period during which borrowers are not required to make payments while enrolled in school at least half time. This period begins on the date the loan is first disbursed and ends six to nine months after the borrower ceases to be enrolled in school at least half time. The standard repayment period is 15 to 20 years, depending on the type of student loan. Borrowers can choose to receive electronic communications, in which case they will receive e-mail notifications of the availability of their monthly billing statements online. There is no prepayment penalty, and borrowers may decide whether or not to apply any excess payments toward their next monthly payments and advance their due date.

We calculate interest on a daily basis on the outstanding principal loan balance until the loan is paid in full. The interest rate will never be higher than the maximum allowed by law, as stated in the promissory note and disclosures. If a student loan has a variable interest rate, it is equal to a variable index (e.g., based on the prime rate, LIBOR or T-Bill) plus a fixed margin assigned to the loan during origination. Variable interest rates may adjust quarterly if the index changes. We notify borrowers of any changes in the interest rate as required by law. We may impose other charges, including late charges when a customer has not made a minimum payment by the required due date, and a returned check charge. In certain circumstances, we may offer forbearance periods of up to 12 months over the life of the loan.

Personal Loans

The terms and conditions governing personal loans are set at the time the loan is accepted and generally do not change for the life of the loan. Personal loan account terms and conditions are generally uniform from state to state. All personal loan accounts generally have the same billing structure. Customers receive monthly statements approximately 20 days prior to payment due dates. The statement provides detail on all transactions processed since the last statement was generated, as well as a summary of the current amount due. Customers also can waive their right to receive physical copies of their bills, in which case they will receive email notifications of the availability of their billing statements online. Personal loan accounts are assessed periodic finance charges using simple interest. We may impose other charges, including late charges when a customer has not made a minimum payment by the required due date, and a returned check charge. There is no prepayment penalty for repaying a personal loan balance in full prior to the scheduled maturity date.

Home Loans and Home Equity Loans

We offer prime variable, fixed-rate conforming, jumbo and FHA home loans to qualified applicants. The terms of the loan are set at closing. Substantially all funded loans and the related loan servicing rights are sold to investors in the secondary market, generally within 30 days of funding.

Home equity loans are fixed rate loans that carry a monthly payment over the term of the loan and are secured by a customer's home. The terms of the loan are set at closing. Customers are sent monthly statements 20 days in advance of the payment due date. The statements provide the customer the allocation of any payments made since the last billing date as well as the payment due on the next scheduled payment date. The customer has the ability to view their account information as well as make payments online through the account center. Customers are also subject to additional charges, including late fees and returned payment charges. The customer has the ability to make larger than minimum payments on the loans and early payoffs are not subject to a pre-payment penalty.

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Deposits

We offer four main types of deposit products directly to consumers on a national basis: certificates of deposit, savings accounts, money market and checking accounts. All of these deposits are FDIC-insured to the maximum extent permitted by law. Interest is compounded daily and credited to each account on a monthly basis for certificates of deposit, savings accounts and money market accounts, using the daily balance method and daily periodic rates. We do not pay interest on checking account balances, but instead offer cashback rewards for certain transactions. We offer a range of ownership options, including single, joint, trust and custodial. Deposit accounts may be funded through electronic fund transfer, check or wire transfer. Customers may access account servicing through a variety of convenient methods, including online at www.discoverbank.com, mobile and tablet device applications, and by telephone.

Certificates of deposit are offered on a full range of tenors from three months through 10 years with interest rates that are fixed for the full period. We offer automatic renewal along with options on reinvestment or disbursement of interest. There are minimum balance requirements to open accounts and penalties for early withdrawals. Certificates of deposit are offered with interest in multiple tax options. Customers can choose to receive interest either periodically or at maturity. Money market accounts are transactional accounts with minimum balance requirements. Money market account funds may be accessed through electronic fund transfer, checks, wire transfer and debit cards. Savings accounts may be accessed through electronic fund transfer, wire transfer and official checks. Money market accounts and savings accounts have limitations on withdrawal frequency, as required by law. Interest rates on money market accounts and savings accounts are subject to change at any time. Fees apply to some transactions, and availability of funds varies based on product and method of funding.

We also issue certificates of deposit through select contracted brokerage firms. All of these deposits are also FDIC-insured to the maximum extent permitted by law. All settlements occur through the Depository Trust Company. Tenors issued, interest, and commission rates are determined weekly with tenor issuances of five months to ten years. Simple interest is applied to brokered certificates of deposit. At any given time, we may choose to not issue these certificates of deposit or to issue only certain tenors in a given week. Early redemption of these certificates occurs only in the event of death or insanity. We have also entered into several third party agreements which provide structured sweep deposit balances.

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 for small- and mid-size merchants. In addition to our U.S.-based merchant acceptance locations, Discover Network cards also are accepted at many locations in Canada, Mexico, the Caribbean, China, Japan and 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-to-network).

We maintain direct relationships with most of our largest 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 also are accompanied by additional program documents that further define our network functionality and requirements, including operating regulations, technical specifications and dispute rules. To enable ongoing improvements in our network's functionality and in accordance with industry convention, we publish updates to our program documents on a semi-annual basis. Discover card transaction volume was concentrated among our top 100 merchants in the 2013 calendar year with our largest merchant accounting for approximately 8% of total Discover card transaction volume.

In order to increase merchant acceptance, 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

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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, 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., 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 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 and payment networks on the basis of a number of factors, including brand, reputation, customer service, product 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, Capital One, JPMorgan Chase 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 cash rewards programs, however, has increased in recent years. Our student loan product competes for customers with Sallie Mae and Wells Fargo, as well as other financial institutions that offer student loans. Our personal loan product competes for customers primarily with JPMorgan Chase, Capital One, Wells Fargo and Citi. Our home loan product competes for customers primarily with traditional lending institutions, namely Wells Fargo, Bank of America, JPMorgan Chase and Citi, which operate in multiple distribution channels, including direct to consumer. Our home loan product also faces additional competition from direct lending websites owned and operated by other online lenders that originate the bulk of their loans through their websites or by phone. Our home equity product faces competition primarily from traditional branch lending institutions like Wells Fargo, JP Morgan Chase, US Bank and PNC.

Although our student and personal loan receivables have increased, our credit card receivables continue to represent most of our receivables. The credit card business is highly competitive. Some of our competitors offer a wider variety of financial products than we do, including automobile loans, 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 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 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 new entrants to the market, such as online networks, telecom providers and other alternative payment providers, 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 direct competitors, including USAA, Ally Financial, American Express, Capital One (360), Sallie Mae and Barclays. We also compete with traditional banks and credit unions that source deposits through branch locations. We seek to differentiate our deposit product offerings on the basis of brand reputation, convenience, 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 Risks."

Intellectual Property

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

Employees

As of January 31, 2014, we employed approximately 14,128 individuals.

Risk Management

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

Enterprise Risk Management Principles

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

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Comprehensiveness

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

Accountability

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

Independence

We maintain independent risk and control functions including our corporate risk management, law and compliance, and internal audit departments. Our Chief Risk Officer, who leads our corporate risk management department, is appointed by our board of directors and is accountable for providing an independent perspective on the risks to which we are exposed; how well management is identifying, assessing and managing risk; and the capabilities we have to manage risk across the enterprise.

Defined Risk Appetite and Strategic Limits

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

Control Assessment

We test control effectiveness in a variety of ways. Our Risk and Control Self Assessment (RCSA) program is designed to identify, self-assess, monitor and report risks and controls in our products, processes and systems, and is an integral part of our risk management framework. As an enterprise risk management process, our overarching risk categories and related definitions are incorporated into the RCSA, and the risk governance structure is utilized for RCSA reporting. The entire process is subject to audit by our internal audit department with reporting to our Risk Committee and the Audit and Risk Committee of our board of directors.

Transparency

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

Risk Management Roles and Responsibilities

Our governance structure is based on the principle that each line of business is responsible for managing risks inherent in its business with appropriate corporate oversight. Our board of directors, the Audit and Risk Committee of our board of directors, our Risk Committee, our Chief Executive Officer and senior executive officers, our corporate risk management department, our law and compliance department, and our internal audit department provide oversight at various levels.

Board of Directors

Our board of directors is responsible for: (i) approval of certain risk management policies, (ii) approval of our risk appetite and strategic limit framework, (iii) oversight of our strategic plan, and (iv) appointment of our Chief Risk Officer.

Audit and Risk Committee of our Board of Directors

The Audit and Risk Committee of our board of directors reviews reports from management on our enterprise-wide risk management program. The Committee also reviews with management the framework for assessing and

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managing our risk exposures and the steps management has taken to monitor and control such risk exposures. The Committee also reviews reports from management on the status of and changes to risk exposures, policies, procedures and practices.

Risk Committee

Our Risk Committee is an executive management-level committee, authorized by the Audit and Risk Committee of our board of directors and chaired by our Chief Risk Officer, that provides a forum for our senior management team to review and discuss credit, market, liquidity, operational, legal and compliance, and strategic risks across the company and for each business unit. Risk Committee membership consists of all members of our Executive Committee. The Committee regularly provides reports of our Chief Risk Officer to the Audit and Risk Committee of our board of directors on risks and risk management. Our Risk Committee has formed a number of sub-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 necessary. These risk management committees include the Asset/Liability Management Committees (Discover Financial Services and Discover Bank), the Capital Planning Committee, the Counterparty Credit Committee, the Discover Bank Credit Committee, the New Initiatives Committee, the Operational Risk Committee, and the Compliance Committee.

Chief Executive Officer

Our Chief Executive Officer is ultimately responsible for our risk management. In that capacity, our Chief Executive Officer establishes our risk management culture and ensures the business operates in accordance with it. Our Chief Risk Officer reports to our Chief Executive Officer.

Senior Executive Officers

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

Chief Risk Officer

Our Chief Risk Officer chairs our Risk Committee and manages our corporate risk management department. Our Chief Risk Officer is responsible for establishing and implementing standards for the identification, management and measurement of risk on an enterprise-wide basis, as well as for monitoring and reporting such risks.

Corporate Risk Management

Our corporate risk management department is led by our Chief Risk Officer and supports business units by providing objective oversight of our risk profile and ensuring risks are managed as defined by policy. Our corporate risk management department also provides risk management tools and policies, and aggregates and reports our risks to our board of directors, the Audit and Risk Committee of our board of directors and our Risk Committee.

Law and Compliance Department

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

Internal Audit Department

Our internal audit department is responsible for performing periodic, independent reviews and testing of compliance with our risk management policies and standards, performing assessments of the design and operating

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effectiveness of these policies and standards, and validating that all risk management controls are functioning as intended. The head of our internal audit department reports to the Audit and Risk Committee of our board of directors.

Risk Appetite and Strategic Limit Structure

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

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

Risk Categories

Our risk management program is organized around six major risk categories: credit risk, market risk, liquidity risk, operational risk, compliance and legal risk, and strategic risk. 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

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

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

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

Market Risk

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

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Liquidity Risk

Liquidity risk is the potential that we will be unable to meet our obligations as they come due because of an inability to obtain adequate funding or liquidate assets without significantly lowering market prices because of inadequate market depth or market disruptions. Liquidity risk exposures are overseen by our Asset/Liability Management Committee. The responsibilities of our Asset/Liability Management Committee are described above.

Operational Risk

Operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or external events will result in reputational harm or losses. Operational risk also arises from model risk, which is the potential that we will incur a financial loss, make incorrect business decisions or cause damage to our reputation as a result of: (i) errors in financial and decision model design and development, (ii) misapplication of financial or decision models, or (iii) errors in the financial and decision model production process. We further differentiate operational risk into the following sub-categories: theft and fraud; employment practices and workplace safety; customer, products and business practices; technology; physical asset and data security; processing; financial and reporting; and external provider.

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

Compliance and Legal Risk

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

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

Strategic Risk

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

Our corporate risk management department also plays an important role in the management of strategic risk by: (i) overseeing the objective setting and strategic planning processes from a risk perspective, to gain comfort that strategic risks have been adequately considered in the setting of objectives and development of strategies;

(ii) providing an independent risk perspective to the new initiatives process; and (iii) assessing if there is effective alignment of

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management's proposed long-term strategic objectives with the risk appetite and strategic limits approved by our board of directors.

Capital Planning

Our capital planning and capital adequacy assessment process is designed to ensure capital adequacy against identified risks. Our Capital Planning Committee, which is chaired by our Chief Financial Officer, oversees the development of our strategic capital plans. Our plans are reviewed and approved by our board of directors. We submit an annual capital plan to the Federal Reserve as further described in "— Supervision and Regulation — Capital, Dividends and Share Repurchases" and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Capital."

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, and 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 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.

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

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 "Reform Act") enacted in July 2010, we are required to meet certain capital and management criteria to maintain our status as a

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financial holding company. If we or our depository institutions were to fail to continue to meet the criteria for financial holding company status, we could, depending on which requirements we failed to meet, face restrictions on new financial activities or acquisitions and/or be required to discontinue existing activities that are not generally permissible for bank holding companies.

Federal Reserve regulations and the Federal Deposit Insurance Act, as amended by the Reform 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 Reform Act addresses risks to the economy and the payments system, especially those posed by large systemically significant financial firms. Bank holding companies with $50 billion or more in total consolidated assets, including Discover, are considered systemically significant under the Reform Act and are subject to heightened prudential standards to be established by the Federal Reserve. The Reform Act could have a significant impact on us by, for example, requiring us to limit or change our business practices, limiting our ability to pursue business opportunities, requiring continued investments of management time and resources in compliance efforts, limiting fees we can charge for services, requiring us to meet more stringent capital, liquidity and leverage ratio requirements, increasing costs, restricting our ability to access the securitization markets for our funding, impacting the value of our assets, or otherwise adversely affecting our businesses. For more information regarding the Reform 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." As a bank holding company, we are required to maintain Tier 1 and total capital equal to at least 4% and 8% of our total risk-weighted assets, respectively. We are also required to maintain a minimum "leverage ratio" (Tier 1 capital to adjusted total assets) of 4% to 5%, depending upon criteria defined and assessed by the Federal Reserve. Further, under the Federal Reserve's annual capital plan requirements, we are required to demonstrate that under stress scenarios we will maintain a Tier 1 common ratio (meaning the ratio of Tier 1 common capital to total risk-weighted assets) above 5%. At December 31, 2013, Discover Financial Services met all requirements to be deemed "well-capitalized." For related information regarding our bank subsidiaries, see "— FDIA" below.

Current or future legislative or regulatory initiatives may require us to hold more capital in the future. In June 2013, the Federal Reserve, Office of the Comptroller of the Currency (the "OCC") and the FDIC finalized rules to implement the provisions of the Basel III regulatory capital reforms that would be applicable to us and Discover Bank. The final rules include new minimum and "well-capitalized" risk-based capital and leverage ratios, effective January 1, 2015, and refine the definition of what constitutes "capital" for purposes of calculating those ratios. Beginning this year, we are subject to the final rules issued by the Federal Reserve and the FDIC implementing the stress test requirements under the Reform Act. For additional information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments — Capital, Liquidity and Funding."

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, 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 required to submit an annual capital plan to the Federal Reserve that includes an assessment of our expected uses and sources of capital over the planning horizon. In January 2014, we submitted our capital plan to be reviewed by the Federal Reserve under the enhanced standards applied under the Federal Reserve's Comprehensive Capital Analysis and Review, or CCAR, program. Therefore, the Federal Reserve now applies enhanced standards to our capital plan submissions, including evaluation based on results of supervisory stress tests and

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enhanced documentation and process standards. Our ability to make capital distributions, including our ability to pay dividends or repurchase shares of our common stock, will be subject to the Federal Reserve's review and non-objection of the actions that we proposed in our annual capital plan.

For more information, including additional conditions and limits on our ability to pay dividends and repurchase our stock, see "Risk Factors — 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 18: Capital Adequacy to our consolidated financial statements.

FDIA

The Federal Deposit Insurance Act (the "FDIA") imposes various requirements on insured depository institutions. For example, the FDIA requires, among other things, the federal banking agencies to take "prompt corrective action" in respect of depository institutions that do not meet minimum capital requirements. The FDIA sets forth the following five capital tiers: "well-capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors that are established by regulation. At December 31, 2013, Discover Bank and Bank of New Castle met all applicable requirements to be deemed "well-capitalized." As noted above, recently-issued Federal Reserve rules and additional future rulemaking, including with respect to implementation of Basel III, have altered and in the future could further alter the capital adequacy framework for Discover.

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. A bank that is "adequately capitalized" and that accepts brokered deposits under a waiver from the FDIC may not pay an interest rate on any deposit in excess of 75 basis points over certain prevailing market rates. There are no such restrictions under the FDIA on a bank that is "well-capitalized." As of December 31, 2013, Discover Bank and Bank of New Castle each met the FDIC's definition of a "well-capitalized" institution for purposes of accepting brokered deposits. An inability to accept brokered deposits in the future could materially adversely impact our funding costs and liquidity. For more information, see “Risk Factors — An inability to accept or maintain deposits in the future could materially adversely affect our liquidity position and our ability to fund our business.”

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

The FDIA subjects Discover Bank to deposit insurance assessments. Under the Reform 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%. The FDIC set a reserve ratio of 2%, 65 basis points above the statutory minimum. The FDIC also amended its deposit insurance

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regulations with two changes. First, the FDIC implemented a provision of the Reform Act that changed the assessment base for deposit insurance premiums from one based on domestic deposits to one based on average consolidated total assets minus average tangible equity. Second, the FDIC revised the risk-based assessment system for all large insured depository institutions (generally, institutions with at least $10 billion in total assets, including Discover Bank) to one based on a scorecard method. Further increases may occur in the future. The Reform Act removed the statutory cap for the reserve ratio, leaving the FDIC free to set a cap 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 information on the challenging 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 CARD Act and the Reform Act. These and other federal laws, among other things, prohibit unfair, deceptive and abusive trade practices, require disclosures of the cost of credit, provide substantive consumer rights, prohibit discrimination in credit transactions, regulate the use of credit report information, provide financial privacy protections, require safe and sound banking operations, restrict our ability to raise interest rates, and subject us to substantial regulatory oversight. 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. Moreover, our U.S. subsidiaries are subject to the Servicemembers Civil Relief Act, which protects persons called to active military service and their dependents from undue hardship resulting from their military service. The Servicemembers Civil Relief Act applies to all debts incurred prior to the commencement of active duty (including credit card and other open-end debt) and limits the amount of interest, including service and renewal charges and any other fees or charges (other than bona fide insurance) that is related to the obligation or liability. 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."

The CARD Act was enacted in 2009, but most of the requirements became effective in 2010. The CARD Act made numerous amendments to the Truth in Lending Act, requiring us to make fundamental changes to many of our business practices, including marketing, underwriting, pricing and billing. The CARD Act's restrictions on our ability to increase interest rates on existing balances to respond to market conditions and credit risk ultimately limit our ability to extend credit to new customers and provide additional credit to current customers. Other CARD Act restrictions have resulted and will continue to result in reduced interest income and loan fee income.

The Reform Act established the CFPB, which regulates consumer financial products and services and certain financial services providers, including Discover. The CFPB is authorized to prevent “unfair, deceptive or abusive acts or practices” and ensure consistent enforcement of laws so that all consumers have access to markets for consumer financial products and services that are fair, transparent and competitive. The CFPB has rulemaking and interpretive authority under the Reform 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. In addition, the CFPB has an online complaint system that allows consumers to log complaints with respect to the products we offer. The system could inform future agency decisions with respect to regulatory, enforcement or examination focus. There continues to be uncertainty as to how the CFPB's strategies and priorities will impact our businesses and our results of operations going forward. For more information, see "Risk Factors — There continues to be uncertainty as to how the Consumer Financial Protection Bureau's priorities and actions will impact our business." and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments — Consumer Financial Services."

We are subject to additional laws and regulations affecting mortgage lenders. We conduct our mortgage lending business through two subsidiaries: Discover Bank (for our home equity loans) and Discover Home Loans, Inc. (for our conventional refinances and purchase transactions), which is a state-licensed mortgage lender. Federal, state and, in some instances, local laws regulate mortgage lending activities. These laws generally regulate the manner in which lending and lending-related activities are marketed or made available, 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. State laws often restrict the amount of interest and fees that may be charged by a mortgage lender, or otherwise regulate the manner in which mortgage lenders operate or advertise. The CFPB has indicated that the mortgage industry is an area of supervisory focus and that it will concentrate its examination and rulemaking efforts on the variety of mortgage-related topics required under the Reform Act, including the steering of consumers to less favorable products, discrimination, abusive or unfair lending practices, predatory lending, origination disclosures, minimum mortgage underwriting standards, mortgage loan origination compensation and servicing practices. The CFPB has published several final rules impacting the mortgage industry. For more information, see “Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments — Consumer Financial Services — Mortgage Lending.”

Most states require licenses for non-bank lenders, such as Discover Home Loans, to solicit or make loans, and require the licensure or registration of certain individual employees engaged in mortgage loan origination activities. In 2008, Congress mandated that all states adopt certain minimum standards for the licensing of individuals involved in mortgage lending, and all state legislatures and state agencies have adopted and are implementing additional licensing, continuing education, and similar requirements on mortgage lenders and their employees. Compliance with existing and any new requirements may render it more difficult to operate or may raise our internal costs. As noted above, Discover Home Loans is subject to examination and supervision by state mortgage regulatory agencies, as well as the CFPB, the Federal Reserve and other federal agencies, and may incur substantial cost in preparing for and responding to regulatory examinations and investigations.

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 Association. In addition, as our payments business has expanded globally through Diners Club, we are subject to government regulation in countries in which our networks operate or our cards are used, either directly or indirectly through regulation affecting Diners Club network licensees. Changes in existing federal, state or international regulation could increase the cost or risk of providing network services, change the competitive environment, or otherwise materially adversely affect our operations. The legal environment regarding privacy and data security is particularly dynamic, and any unpermitted disclosure of confidential customer information could have a material adverse impact on our business, including loss of consumer confidence.

The Reform 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 Reform Act requires that merchants control the routing of debit transactions, and that interchange fees received by certain payment card

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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 Reform 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 implementation of these provisions and potential impacts on our debit card business, see “Risk Factors — Legislative and regulatory reforms related to the debit card market have had a significant impact on our PULSE network business. The changing debit card environment has adversely impacted and we expect that it may continue to adversely impact PULSE's ability to compete for transaction volume." and “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 a compliance officer and undergoes an annual independent audit to assess its effectiveness. Our program is typically reviewed on an annual basis by federal banking regulators. The FDIC is completing its annual anti-money laundering/Bank Secrecy Act examination of Discover Bank and has notified the company of certain potential program deficiencies. See Note 20: Litigation and Regulatory Matters to our consolidated financial statements for more information. Violations and deficiencies related to anti-money laundering and anti-terrorism laws and regulations may cause federal banking regulators to deny, or delay approval of, potential 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.

Executive Officers of the Registrant

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

Name	Age	Position
David W. Nelms	52	Chairman and Chief Executive Officer
Roger C. Hochschild	49	President and Chief Operating Officer
R. Mark Graf	49	Executive Vice President and Chief Financial Officer
Kathryn McNamara Corley	53	Executive Vice President, General Counsel and Secretary
Steven E. Cunningham	44	Senior Vice President, Chief Risk Officer
Carlos M. Minetti	51	Executive Vice President, President - Consumer Banking

Diane E. Offereins	56	Executive Vice President, President - Payment Services
James V. Panzarino	61	Executive Vice President, Chief Credit and Card Operations Officer
R. Douglas Rose	45	Senior Vice President, Chief Human Resources Officer
Glenn P. Schneider	52	Senior Vice President, Chief Information Officer
Harit Talwar	53	Executive Vice President, President - U.S. Cards

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

Roger C. Hochschild has served as President and Chief Operating Officer since 2004, and was Executive Vice President, Chief Marketing Officer from 1998 to 2001. From 2001 to 2004, Mr. Hochschild was Executive Vice President, Chief Administrative Officer and Chief Strategic Officer of our former parent Morgan Stanley.

Mr. Hochschild holds a Bachelor's degree in Economics from Georgetown University and an M.B.A. from the Amos Tuck School at Dartmouth College.

R. Mark Graf has served as Executive Vice President and Chief Financial Officer since April 2011. He was also Chief Accounting Officer until December 2012. Prior to joining us, Mr. Graf was an investment advisor with Aquiline Capital Partners, a private equity firm specializing in investments in the financial services industry. From 2006 to 2008, Mr. Graf was a partner at Barrett Ellman Stoddard Capital. Mr. Graf was Executive Vice President and Chief Financial Officer for Fifth Third Bank from 2004 to 2006, after having served as its Treasurer from 2001 to 2004. He holds a Bachelor's degree from the Wharton School of the University of Pennsylvania.

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

Steven E. Cunningham has served as Senior Vice President and Chief Risk Officer since May 2013. He is also responsible for the Comprehensive Capital Analysis and Review and Resolution Planning program offices. Prior thereto, Mr. Cunningham served as Senior Vice President and Treasurer since 2010. Prior to joining us, Mr. Cunningham was the Chief Financial Officer for Harley Davidson Financial Services from 2009 to 2010. From 2000 to 2009 he served in several financial and treasury roles with Capital One Financial, including Chief Financial Officer of the company’s banking and auto finance segments. From 1991 to 2000, Mr. Cunningham was at the FDIC in the Atlanta and Washington, D.C. offices. He holds a Bachelor's degree in finance from the University of Alabama and a M.B.A. from The George Washington University.

Carlos Minetti has served as Executive Vice President, President of Consumer Banking since February 2014. Prior thereto, he served as Executive Vice President, President - Consumer Banking and Operations since April 2010, Executive Vice President, Cardmember Services and Consumer Banking from September 2006 through March 2010, and Executive Vice President, and Chief Risk Officer for Cardmember Services and Risk Management from January 2001 through August 2006. Prior to joining us, Mr. Minetti worked in card operations and risk management for American Express from 1987 to 2000, most recently as Senior Vice President. Mr. Minetti holds a Bachelor's of Science degree in Industrial Engineering from Texas A & M University and an M.B.A. from the University of Chicago.

Diane E. Offereins has served as Executive Vice President, President - Payment Services since April 2010. Prior thereto, she served as Executive Vice President, Payment Services since December 2008 and Executive Vice President and Chief Technology Officer since 1998. In addition, she was appointed to oversee the PULSE network in 2006. From 1993 to 1998, Ms. Offereins was at MBNA America Bank, most recently as Senior Executive Vice President. Ms. Offereins holds a Bachelor's of Business Administration degree in Accounting from Loyola University.

James V. Panzarino has served as Executive Vice President and Chief Credit and Card Operations Officer since February 2014. Prior thereto, he served as Executive Vice President and Chief Credit Risk Officer from 2009 to 2013. Prior thereto, he served as Senior Vice President and Chief Credit Risk Officer from 2006 to 2009, and Senior Vice President, Cardmember Assistance, from 2003 to 2006. Prior to joining us, Mr. Panzarino was Vice President of External Collections and Recovery at American Express from 1998 to 2002. Mr. Panzarino holds a Bachelor's degree in Business Management and Communication from Adelphi University.

R. Douglas Rose has served as Senior Vice President and Chief Human Resources Officer since April 2013. Prior thereto, he served as Vice President, Human Resources at United Airlines from May 2009 to March 2013. He was also Senior Vice President, Human Resources at Capital One and a Human Resources consultant for Hewitt Associates. Mr.

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Rose holds a Bachelor's degree from the University of Pennsylvania and a Master's degree from the University of Michigan.

Glenn P. Schneider has served as Senior Vice President and Chief Information Officer since December 2008. From 2003 to 2008, he was Senior Vice President, Application Development, and from 1998 to 2003, he served as Vice President, Marketing Applications. Mr. Schneider joined us in 1993 and prior thereto worked for Kemper Financial Services as a Programmer. He holds a Bachelor's degree in Economics/Computer Science and a minor in Statistics from Northern Illinois University.

Harit Talwar has served as Executive Vice President, President - U.S. Cards since April 2010. Prior thereto, he served as Executive Vice President, Card Programs and Chief Marketing Officer since December 2008 and Executive Vice President, Discover Network since December 2003. From 2000 to 2003, Mr. Talwar was Managing Director for our international business. Mr. Talwar held a number of positions at Citigroup from 1985 to 2000, most recently as Country Head, Consumer Banking Division, Poland. Mr. Talwar holds a B.A. Hons degree in Economics from Delhi University in India and an M.B.A. from the Indian Institute of Management, Ahmedabad.

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Item 1A. Risk Factors

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

Current Economic and Regulatory Environment

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

While certain economic conditions in the United States have shown signs of improvement, economic growth has been slow and uneven as consumers continue to be affected by high unemployment rates and depressed housing values. In addition, the economic and financial challenges in Europe and globally may continue to impact economic recovery generally and the financial services industry. A prolonged period of slow economic growth or a significant deterioration in economic conditions would likely affect the ability and willingness of customers to pay amounts owed to us. A customer's ability to repay us also can be negatively impacted by increases in their payment obligations to other lenders under mortgage, credit card and other consumer loans. We believe that we are experiencing generally historical lows in our delinquency and charge-off rates and that these rates will be increasing over time. In addition, if economic conditions worsen, these rates may increase more than expected. The over 30 days delinquent rate was 1.64% at December 31, 2013, down from 1.69% and 2.29% at December 31, 2012 and November 30, 2011, respectively. The full-year net charge-off rate was 1.98% for the 2013 calendar year, down from 2.29% and 3.97% for the 2012 and 2011 fiscal years, respectively. Growth in our loan portfolio led us to increase our allowance for loan losses in the second half of 2013. We expect further increases in our allowance for loan losses in 2014, which will negatively impact our net income compared to 2011 through 2013, when reserve releases significantly contributed to our net income.

Poor economic conditions not only affect the ability and willingness of customers to pay amounts owed to us, increasing delinquencies, charge-offs and allowance for loan losses as described above, but 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 net interest income from credit card loans was $6.0 billion for the 2013 calendar year, which was 73% of revenues (defined as net interest income plus other income), compared to $5.8 billion for the 2012 fiscal year, which was 75% of revenues, and $5.7 billion for the 2011 fiscal year, which was 80% of revenues. In the event of another economic downturn, we may have to consider expense-reduction initiatives in order to offset our inability to generate increased interest and fee income due to existing legal and regulatory limitations on increasing interest and fees. Slow economic recovery combined with a competitive marketplace could result in Discover being unable to grow loans, resulting in reduced revenue from its core direct banking business.

The regulatory environment for the financial services industry is being significantly impacted by financial regulatory reform initiatives, which may adversely impact our business, results of operations and financial condition.

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Reform Act") contains comprehensive provisions governing the practices and oversight of financial institutions and other participants in the financial markets. The Reform Act regulates large systemically significant financial firms, including us, through a variety of measures, including increased capital and liquidity requirements, limits on leverage, and enhanced supervisory authority. The Reform Act also established a new financial industry regulator, the Consumer Financial Protection Bureau (the "CFPB"), and new requirements for debit card transactions, which impact our core businesses and are described in other risk factors below related to consumer financial services, payment services, risk management practices, and capital and liquidity. Additional legislative or regulatory action that may impact our business may result from the multiple studies mandated under the Reform Act.

The evolving regulatory environment causes uncertainty with respect to the manner in which we conduct our businesses and requirements that may be imposed by our regulators. Regulators have implemented and continue to propose new regulations and issue supervisory guidance and have been increasing their examination and enforcement

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action activities. The FDIC is completing its annual anti-money laundering/Bank Secrecy Act examination of Discover Bank and has notified the company of certain potential program deficiencies, and the CFPB is investigating certain student loan servicing practices of Discover Bank. See Note 20: Litigation and Regulatory Matters to our consolidated financial statements for more information. We expect that regulators will continue taking formal enforcement actions against financial institutions in addition to addressing supervisory concerns through non-public supervisory actions or findings. We are unable to predict the nature, extent or impact of any additional changes to statutes or regulations, including the interpretation, implementation or enforcement thereof, which may occur in the future.

The impact of the evolving regulatory environment on our business and operations depends upon a number of factors including final implementing regulations, guidance and interpretations of the regulatory agencies, supervisory priorities and actions, the actions of our competitors and other marketplace participants, and the behavior of consumers. The evolving regulatory environment could require us to limit or change our business practices, limit our product offerings, require continued investment of management time and resources in compliance efforts, limit fees we can charge for services, require us to meet more stringent capital, liquidity and leverage ratio requirements, increase costs, restrict our ability to access the securitization markets for our funding, impact the value of our assets, or otherwise adversely affect our businesses. The regulatory environment and enhanced examination and supervisory expectations and scrutiny can also potentially impact our ability to pursue business opportunities and obtain required regulatory approvals for potential investments and acquisitions. For additional information see "Business — Supervision and Regulation — Acquisitions and Investments."

Compliance and other regulatory requirements and expenditures have increased significantly for Discover and other financial services firms, and we expect them to continue to increase as regulators adopt new rules, interpret existing rules and increase their scrutiny of financial institutions, including controls and operational processes. We may face additional compliance and regulatory risk to the extent that we enter into new lines of business or new business arrangements with third-party service providers, alternative payment providers or other industry participants, including providers or participants that may not be regulated financial institutions. The additional expense, time and resources needed to comply with ongoing regulatory requirements may adversely impact our business and results of operations. In addition, regulatory findings and ratings could negatively impact our business strategies.

There continues to be uncertainty as to how the Consumer Financial Protection Bureau's priorities and actions will continue to impact our business.

The CFPB, which commenced operations in July 2011, has a large budget and staff, and broad authority with respect to the products that we offer, as further described in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments." There continues to be significant uncertainty as to how the agency's regulatory, supervisory, examination and enforcement strategies and priorities will impact our business and our results of operations going forward. In September 2012, Discover Bank entered into a consent order with the FDIC and CFPB with respect to the marketing of our protection products, which required us to provide refunds of approximately $200 million to eligible customers, pay a $14 million civil monetary penalty and enhance our business processes. Several of our other products, including credit cards, student loans and home loans, are areas of focus by the CFPB. The CFPB is currently investigating certain student loan servicing practices of Discover Bank. See Note 20: Litigation and Regulatory Matters to our consolidated financial statements for more information. Although we have committed significant resources to enhancing our compliance programs, changes in regulatory expectations, interpretations or practices could increase the risk of enforcement actions, fines, penalties and customer restitution. Actions by the CFPB could result in requirements to alter our products and services that would make our products less attractive to consumers and impair our ability to offer them profitably. Future actions by the CFPB or other regulators that discourage the use of products we offer or steer consumers to other products or services could result in reputational harm and a loss of customers. Should the CFPB change regulations adopted in the past by other regulators, or modify past regulatory guidance, our compliance costs and litigation exposure could increase. Our consumer class action litigation exposure could increase if the CFPB exercises its authority to limit or ban pre-dispute arbitration clauses. A preliminary report on arbitration agreements issued by the CFPB expressed concerns about these agreements that may signal the agency is contemplating taking such steps.

Legislative and regulatory initiatives related to the student loan market may have a significant impact on our ability to profitably grow our student loan portfolio.

We have invested in the growth of our private student loan portfolio, including through the acquisition of The Student Loan Corporation in December 2010 and the acquisition of additional private student loans from Citi in

September 2011. Our total student loans have grown from $1.0 billion at November 30, 2010 to $8.1 billion at December 31, 2013. There is significant legislative and regulatory focus on the student loan market, including by the CFPB, as described in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments." This regulatory focus has resulted in an increase in supervisory examinations of the company related to student loans. The CFPB is currently investigating certain student loan servicing practices of Discover Bank. See Note 20: Litigation and Regulatory Matters to our consolidated financial statements for more information. Regulators, Congress or the Administration may take actions that impact the student loan market in the future. Any such actions could cause us to restructure our private student loan business in ways that we may not currently anticipate. The possible impact of heightened scrutiny of the student loan market and its participants, including any resulting legislative and regulatory initiatives, is uncertain and may adversely impact the profitability and growth of our private student loan portfolio.

Legislative and regulatory reforms related to the debit card market, as well as competitors' responses to these reforms, have had a significant impact on our PULSE network business. The changing debit card environment has adversely impacted and we expect that it may continue to adversely impact PULSE's ability to compete for transaction volume.

The Reform Act contains several provisions impacting the debit card market as further described in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments." The changing debit card environment, including competitor actions related to merchant and acquirer transaction routing strategies, has adversely affected and may continue to adversely affect our PULSE network's business practices, network transaction volume, revenue, and prospects for future growth. We continue to face competitive challenges from the new merchant and acquirer transaction routing strategies implemented by large competing networks following the issuance of the regulations related to debit routing and fees. We are closely monitoring these strategies in order to assess their impact on our business and on competition in the marketplace. The U.S. Department of Justice is examining some of these competitor pricing strategies. In addition, the Reform Act's network participation requirements impact PULSE's ability to enter into exclusivity arrangements, which affect PULSE's current business practices and may materially adversely affect its network transaction volume and revenue. Our transaction processing revenue was $192 million for the calendar year ended December 31, 2013 and $218 million and $180 million for the fiscal years ended November 30, 2012 and 2011, respectively. While we are still assessing all of our options for responding to these developments, they have adversely impacted PULSE and we expect that they may continue to adversely impact our ability to compete for issuer participation and merchant and acquirer routing, negatively impacting PULSE transaction volume growth.

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 and 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 on the basis of a number of factors, including brand, reputation, customer service, product offerings, incentives, pricing 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, are 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, combined with slow economic recovery, could result in Discover being unable to grow loans, resulting in reduced revenue from its 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 expenses 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 expenses in competing with other consumer financial services providers to attract and retain customers and increase usage of our products. A substantial portion of these expenses relates to marketing expenditures. We incurred expenses of $717 million in the 2013 calendar year and $603 million and $537 million in the 2012 and 2011 fiscal years, respectively, for marketing and business development. 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. This type of competition has adversely affected credit card yields, and customers may frequently switch credit cards or transfer their balances to another card. There can be no assurance that any of the expenses we incur or incentives we offer to attempt to acquire and maintain accounts and increase usage of our products will be effective.

Furthermore, many of our competitors are larger than we are, have greater financial resources than we do, have more breadth in consumer banking products, and/or have lower funding and operating costs than we have and expect to have, and have assets such as branch locations and co-brand relationships, that may help them compete more effectively. 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 expenses directly affect our earnings results. Many factors can influence the amount of our expenses, as well as how quickly they may increase. Our ongoing investments in infrastructure, which may be necessary to maintain a competitive business, integrate newly-acquired businesses, and establish scalable operations, may increase our expenses. In addition, as our business develops, changes or expands, additional expenses 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 integration of newly-acquired businesses. If we are unable to successfully manage our expenses, 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.

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. Competition with other operators of payment networks is generally based on issuer fees, fees paid to networks (including switch fees), merchant acceptance, network functionality and other economic terms. Competition also is based on customer perception of service quality, brand image, reputation and market share. Further, we are facing increased competition from alternative payment providers, who may create innovative network 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 than we do. These competitors have provided financial incentives to card issuers, such as large cash signing bonuses for new programs, funding for and sponsorship of marketing programs and other bonuses. Visa and MasterCard each have been in existence for more than 40 years and enjoy greater merchant acceptance and broader global brand recognition than we do. Although we have made progress in merchant acceptance, we have not achieved 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 credit cards on the Discover Network or issuing debit cards on the PULSE network. Some of these arrangements are exclusive, or nearly exclusive, which further limits our ability to conduct material amounts of business with these institutions. 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, competitor's settlements with merchants and related actions, including pricing pressures and/or surcharging, could negatively impact our business practices. The Reform Act, which gives merchants control of the routing of debit transactions, has

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influenced the competitive environment for the PULSE network. For more information, see the risk factor above addressing legislative and regulatory reforms related to the debit card market.

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. As a result, those competitors could subject the company to adverse restrictions and our business may be adversely affected.

Our business depends upon relationships with issuers, merchant acquirers and licensees, which are generally 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. In the fourth quarter of 2013, we received notice that certain contracts related to one third-party issuing relationship will be terminated, effective mid-2014. This loss will have a meaningful impact on our network partners volume and payment services segment profits, but we do not anticipate it to be material to our overall profitability.

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

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

The Diners Club business also depends upon our ability to maintain the full operability of the Diners Club network for existing Diners Club cardholders, network licensees and merchants. Citigroup continues to own and operate network licensees generating a significant share of the Diners Club network sales volume. Citigroup has been reducing assets outside its core businesses, including certain Diners Club businesses, by selling its ownership interest. If Citigroup were to discontinue its support of a significant number of, or key, Diners Club network licensees, we may face difficulty maintaining and growing our international network. This could adversely affect the acceptance of Discover cards when they are used outside of North America.

The Diners Club business depends upon the cooperation and support 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, Diners Club does not issue cards or determine the terms and conditions of cards issued by the network licensees, with the exception of the Diners Club Italy issuing business, which we acquired in the second quarter. This is the responsibility of each licensee. Further, unlike the Discover Network, we have only a small number of direct merchant and direct merchant acquiring relationships in the Diners Club network. Instead, we rely on network licensees located outside the United States to help us sustain and grow our international business. As a result of a number of factors, including any difficulties in achieving full card acceptance across our networks, network licensees may choose not to renew the license agreements with us when their terms expire. In addition, the increasingly competitive marketplace for cross-border issuance and acceptance of credit cards may result in lower participation fees for the Diners Club network. Many of the merchants in the acceptance network, primarily small and mid-size merchants, may not be contractually committed to the network licensees for any period of time and may cease to participate in the Diners Club network at any time on short notice. If we are unable to continue our relationships with network licensees or if the network licensees are unable to continue their relationships with merchants, our ability to maintain or increase revenues and to remain competitive would be adversely affected. Interruption of these relationships might also have an adverse effect on the acceptance of Discover cards when they are used on the Diners Club network outside of North America.

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We depend on the continuous operation of our licensees. 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. As previously disclosed, we have been working with our European Diners Club licensees with regard to their ability to maintain financing sufficient to support business operations. For example, we acquired Diners Club Italy and we provided financial assistance to facilitate the purchase of our Slovenian licensee by a European bank. These transactions resulted in a charge to earnings of approximately $40 million in the second quarter of 2013. Certain other Diners Club licensees continue to face financial difficulties, due in large part to the challenging European credit market. Going forward, we may provide other forms of support, which may include additional loans, facilitating transfer of ownership, or acquiring assets or licensees, which may cause us to incur additional losses.

We rely upon numerous other network partners for merchant acceptance for existing Diners Club customers. We completed rerouting merchant transactions for foreign Diners Club cards transacting in North America from the MasterCard acceptance network to the Discover Network in 2011. If we are unable to continue to offer acceptable North American merchant acceptance to Diners Club customers, we may experience decreased transaction volume, which would reduce our revenues. Also, as we have nonamortizable 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 that, when recognized, could have a material adverse impact on our consolidated financial condition and results of operations. The long-term success of our acquisition of Diners Club depends upon achieving full card acceptance across our networks, which could include higher overall costs or longer timeframes than anticipated. If we are unable to successfully achieve full card acceptance across our networks, we may be unable to achieve the synergies we anticipate and to grow our business internationally.

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.

In December 2010, we purchased The Student Loan Corporation and, in September 2011, we purchased additional private student loans from Citibank. The acquisitions significantly increased the size of our private student loan portfolio, which has grown from $1.0 billion at November 30, 2010 to $7.3 billion at November 30, 2011 to $7.8 billion at December 31, 2012 and $8.1 billion at December 31, 2013. The long-term success of our student loan strategy depends upon our ability to manage the credit risk, pricing, funding, operations and expenses of a larger student loan portfolio, as well as grow student loan originations. Our student loan strategy is also impacted by external factors such as a poor economic environment, a challenging regulatory environment and a competitive marketplace. The CFPB is currently investigating certain student loan servicing practices of Discover Bank. See Note 20: Litigation and Regulatory Matters to our consolidated financial statements for more information. Slow economic recovery combined with government and regulatory focus on student lending and competitive factors, such as the need to offer fixed interest rates, 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 product 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.

The success of our mortgage business acquisition depends upon our ability to maintain the operations, integrate and manage the risks of this business, and to successfully market, originate and sell mortgage loans. If we are unable to do so, the profitability of our mortgage business would be adversely affected.

In June 2012, we purchased, through our subsidiary Discover Home Loans, substantially all of the operating and related assets of Home Loan Center, a subsidiary of Tree.com, adding a residential mortgage component to our direct banking business. We are now originating residential mortgages for sale in the secondary mortgage markets on a servicing-released basis. As we continue to integrate this new business, we could experience operational interruptions that could damage relationships with customers, vendors and secondary market investors, any or all of which could negatively impact our business and results of operations. Additionally, if we are unable to retain employees, especially those in key management positions, our business and results of operations could be negatively affected.

The long-term success of our mortgage business depends upon our ability to market, originate, fund and sell Discover mortgage loans. Our mortgage loan origination volume will be largely dependent on our ability to offer competitively priced, desirable loan products under the Discover brand and our ability to attract qualified prospective borrowers. Consumers may be hesitant to originate a mortgage with us due to our recent entry into the industry. Our

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origination volumes also may be affected by certain external factors outside our control, including adverse economic conditions, such as higher long-term interest rates, high unemployment and depressed housing values, which may result in some consumers delaying new home purchases or refinances. We expect refinance mortgage loan volume to continue to comprise a substantial, but decreasing percentage of overall mortgage loan volume for our business in the near term. In 2013, mortgage rates rose sharply, which has led to a significant decrease in refinance activity within the mortgage industry. This puts pressure on our business to continue to develop our purchase mortgage capability to replace some of the lost refinance volume. Historically, direct-to-consumer businesses have been more successful in the refinance business and less successful in the purchase market, and there is a risk that we will not be successful in developing a scalable direct-to-consumer purchase mortgage origination business. An inability to attract customers in the purchase market would lead to fewer loan originations, which would adversely affect our ability to grow the business and would result in reduced earnings.

We use third parties to assist us in attracting prospective mortgage borrowers, and our origination volumes may be affected by their ability to successfully attract such borrowers and provide leads to us. We purchase leads from Tree.com pursuant to an agreement related to the acquisition of the Home Loan Center business, which expires this year. If the volume of leads available for us to purchase from Tree.com were significantly reduced and we could not substitute with purchases from other market providers, our origination volume may be negatively impacted, which would adversely affect our results of operations.

Our success also will depend upon relationships with financial intermediaries, including secondary market purchasers, to which we expect to sell eligible mortgages on a servicing-released basis, and our warehouse lender, which provides funding from the time we fund a customer's mortgage until it is sold to a secondary market purchaser. The secondary mortgage markets, as well as the availability of mortgage financing, have experienced disruptions resulting from reduced investor demand for mortgage loans (including the government-sponsored enterprises, Fannie Mae and Freddie Mac) and mortgage-backed securities and increased investor yield requirements for those loans and securities. Most of the market liquidity in the mortgage industry is provided, either directly or indirectly, by government sponsored entities or government agencies. Any attempts to shift market liquidity to private capital sources could impose risk to the mortgage industry to the extent that changes reduce the capacity of available funding. In addition, our recent entry into the mortgage industry, as well as continued concern about the stability of the housing market and the strength of counterparties generally, could result in fewer opportunities to sell our loans in the secondary market and servicing rights on attractive terms. If we are unable to sell our loans in the secondary market or are unable to sell servicing, we could incur additional credit risk and losses. If we are unable to retain the warehouse facility we use to fund our mortgage originations or if the costs associated therewith become unattractive, funding costs and liquidity could be adversely impacted. Furthermore, when we sell the rights to service loans we originate, we expose ourselves to the risk that borrowers will be dissatisfied with their experience with the servicer and will attribute that dissatisfaction to us.

We employ various economic hedging strategies in an attempt to mitigate the interest rate risk and other risks inherent in a mortgage loan commitment. Our hedging activities include entering into derivative instruments. Poorly designed strategies or improperly executed transactions could fail to mitigate our risks and losses, or even increase our risks and losses beyond what they would have been had we not used such hedging strategies.

The mortgage industry is under scrutiny from regulatory agencies, legislation regarding the secondary mortgage market is under consideration by Congress, and our mortgage business is subject to examination and supervision by state mortgage regulatory agencies, as well as the CFPB, the Federal Reserve and other federal agencies, as further described in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments." We may incur substantial cost in preparing for and responding to regulatory examinations and investigations. Failure to comply with applicable laws and regulatory requirements may result in, among other things, suspension or revocation of, or inability to renew, required licenses or registrations, loss of approval status, administrative enforcement actions and fines, refunds or restitution to borrowers, inability to enforce loans we make, loan repurchase or indemnification obligations, private lawsuits, class actions, cease and desist orders, civil and criminal liability, an inability to maintain or enter into new arrangements with secondary mortgage market purchasers or warehouse lenders and reputational risk. Further, the Reform Act and regulatory scrutiny have led to new regulations and regulatory guidance impacting the mortgage industry, and may lead to additional regulations and guidance in the future, which may impact the financial results and prospects for our mortgage business. For example, recent regulatory changes capping points and fees on certain types of mortgages may reduce our origination volume. The long-term success of our mortgage business depends upon our ability to manage our expenses and risks. If we are unable to build scale as planned, we may face difficulty maintaining profitability. We may also incur additional

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expenses and risks if we are unable to successfully address and manage the regulatory and counterparty risks described above or the potential effects of government involvement in the mortgage industry.

We may experience unanticipated losses as a result of mortgage loan repurchase and indemnification obligations under agreements with secondary market purchasers.

We may be required to repurchase mortgage loans that have been sold to secondary market purchasers in the event there are breaches of certain representations and warranties contained within the sales agreements, such as improper underwriting, fraud, or other origination defects. We also may be required to indemnify certain purchasers and others against losses they incur in the event of breaches of representations and warranties and in various other circumstances, and the amount of such losses could exceed the repurchase amount of the related loans. In connection with the sale of loans to certain secondary market purchasers, we also expect to refund premiums paid by secondary market purchasers in instances where the borrower prepays the loan within a specified period of time. We would need to find alternative purchasers for, or arrange with a third party to service, any loans that we are unable to sell or are required to repurchase.

Consequently, we are exposed to credit risk, and potentially funding risk, associated with sold loans due to the risk we may be required to repurchase these loans. We establish reserves in our consolidated financial statements for potential losses related to the risk of having to repurchase mortgage loans we have sold. The adequacy of the reserves and the ultimate amount of losses incurred will depend on, among other things, the actual future mortgage loan performance, the actual level of future repurchase and indemnification requests, the actual success rate of claimants, actual recoveries on the collateral and macroeconomic conditions. Adverse macroeconomic conditions, including high unemployment and depressed housing values, have resulted in missed mortgage payments and foreclosures, negatively impacting the credit performance of mortgages. While the U.S. housing market has experienced some price appreciation in 2013, the increases have been uneven and have not returned to pre-recession levels. A worsening of these conditions would likely exacerbate the adverse effects of these market conditions on the credit performance of mortgages in general. Due to uncertainties relating to these factors, the reserves we establish may not be adequate and losses incurred could adversely affect our financial condition and results of operations.

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.

Our success depends on our ability to manage our credit risk while attracting new customers with profitable usage patterns. We select our customers, manage their accounts and establish terms and credit limits using proprietary scoring models and other analytical techniques that are designed to set terms and credit limits to appropriately compensate us for the credit risk we accept, while encouraging customers to use their available credit. The models and approaches we use may not accurately predict future charge-offs due to, among other things, inaccurate assumptions. While we continually seek to improve our assumptions and models, we may make modifications that unintentionally cause them to be less predictive or 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, such as the recent financial crisis. We believe that we are experiencing generally historical lows in our delinquency and charge-off rates and that these rates will be increasing over time. In addition, if economic conditions worsen, these rates may increase more than expected. The full-year net charge-off rate was 1.98% in the 2013 calendar year, down from the full-year net charge-off rate of 2.29% and 3.97% in the 2012 and 2011 fiscal years, respectively. At December 31, 2013 and 2012, and November 30, 2011, $634 million, or 0.96%, $615 million, or 0.98% and $718 million, or 1.25%, respectively, of our loan receivables were non-performing (defined as loans over 90 days delinquent and accruing interest plus loans not accruing interest). We remain subject to conditions in the consumer credit environment. 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 to repay us can be negatively impacted by increases in their payment obligations to other lenders under mortgage, credit card and other consumer loans. Such changes can result from increases in base lending rates or structured increases in payment obligations, and could reduce the ability of our customers to meet their payment obligations to other lenders and to us. In addition, a customer's ability to repay us can be negatively impacted by the restricted availability of credit to consumers generally, including reduced and closed lines of credit. Customers with insufficient cash flow to fund daily living expenses and lack of access to other sources of credit may be more likely to increase their card usage and ultimately default on their payment obligations to us, resulting in higher credit losses in our portfolio. Our collection operations may not compete effectively to secure more of customers' diminished cash flow than our competitors. In addition, we may not identify customers who are likely to default on their payment obligations to us quickly and reduce our exposure by closing credit lines and restricting authorizations, which could adversely impact our financial condition and results of operations.

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

We continue to expand our marketing of our personal, private student loan and home loan products, including the launch of a new home equity loan product in late 2013. Our personal and private student loan portfolios grew to $4.2 billion and $8.1 billion, respectively, at December 31, 2013, compared to $3.3 billion and $7.8 billion, respectively, at December 31, 2012, and $2.6 billion and $7.3 billion, respectively, at November 30, 2011. We have less experience in these areas as compared to our traditional credit card lending business, and 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 $11.1 billion as of December 31, 2013, compared to $8.3 billion as of December 31, 2012 and $8.5 billion as of November 30, 2011. Our total contingent liquidity sources as of December 31, 2013 amounted to $32.6 billion (consisting of $11.1 billion in our liquidity portfolio, $14.5 billion in incremental Federal Reserve discount window capacity, and $7.0 billion of undrawn capacity in private securitizations), compared to $25.6 billion at December 31, 2012 and $26.2 billion at November 30, 2011.

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, may limit our ability to repay or replace maturing liabilities in a timely manner. As such, we may be forced to delay raising funding or be forced to issue or raise funding at undesirable terms and/or costs, which could decrease profitability and significantly reduce financial flexibility. Regulations such as the liquidity coverage ratio (LCR), as part of the Basel III accord, may increase pricing and impact funding availability and are described more fully in "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments." 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.

While market conditions have stabilized and, in many cases, improved, there can be no assurance that significant disruption and volatility in the financial markets will not occur in the future. For example, recent concerns regarding U.S. debt and budget matters have caused uncertainty in U.S. financial markets. A failure to raise the U.S. debt limit and/or a downgrade of U.S. debt ratings in the future could, in addition to causing economic and financial market disruptions, materially adversely affect the market value of the U.S. government and U.S. agency securities that we hold. Further, a collapse of a financial institution or a downgrade in the debt ratings of another country of systemic importance can have repercussions across the global financial system, negatively impacting the U.S. economy, Discover and Discover's customers. Likewise, adverse developments with respect to financial institutions and other third parties

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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 $28.4 billion in deposits acquired directly or through affinity relationships and $16.4 billion in deposits originated through securities brokerage firms as of December 31, 2013, compared to $28 billion and $14.1 billion, respectively, as of December 31, 2012 and $26.2 billion and $13.3 billion, respectively, as of November 30, 2011. Competition from other financial services firms that use deposit funding and the rates and services we offer on our deposit products 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 financial strength, quality of deposit servicing or online banking generally, which could reduce the number of consumers choosing to make deposits with us, third parties continuing or entering into affinity relationships with us, or third-party securities brokerage firms offering our deposit products.

Our ability to obtain deposit funding and offer competitive interest rates on deposits is also dependent on capital levels of our bank subsidiaries. The Federal Deposit Insurance Act (the "FDIA") prohibits insured banks, including our subsidiary Discover Bank, from accepting brokered deposits (as defined in the FDIA) or offering interest rates on any deposits significantly higher than the prevailing rate in its normal market area or nationally (depending upon where the deposits are solicited), unless (1) it is "well-capitalized" or (2) it is "adequately capitalized" and receives a waiver from the FDIC. A bank that is "adequately capitalized" may not pay an interest rate on any deposit, including direct-to-consumer deposits, in excess of 75 basis points over the national rate published by the FDIC. There are no such restrictions on a bank that is "well-capitalized." As of December 31, 2013, we had brokered deposits (as defined in the FDIA) of $16.4 billion. While Discover Bank met the FDIC's definition of “well-capitalized” as of December 31, 2013, there can be no assurance that it will continue to meet this definition. For a comparison of Discover Bank's capital ratios to the “well-capitalized” capital requirements, see Note 18: Capital Adequacy to our consolidated financial statements. Additionally, our regulators can adjust the requirements to be "well-capitalized" at any time and have authority to place limitations on our deposit businesses, including the interest rate we pay on deposits.

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. Our average level of credit card securitized borrowings from third parties was $14.3 billion for the 2013 calendar year and $14.6 billion and $13.5 billion for the 2012 and 2011 fiscal years, respectively. Although the securitization market for credit cards has been re-established since the financial crisis, there can be no assurance that there will not be future disruptions in the market. 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 maintain the ratings of asset-backed securities issued by our trusts, it could limit our ability to access the securitization markets. Additional factors affecting the extent to which we will securitize our credit card receivables in the future include the overall credit quality of our receivables, the costs of securitizing our receivables, and the legal, regulatory, accounting and tax requirements governing securitization transactions. For example, the Basel Committee on Banking Supervision recently proposed changes to the rules for banks’ calculation of credit risk capital requirements for exposures to securitization transactions. The timing and impact of these proposed rules are unclear at this time, but they could impact the pricing and/or volume of our asset-backed securities issuances. 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.

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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. Credit card securitizations are normally structured as “revolving transactions” that do not distribute to securitization investors their share of monthly principal payments on the receivables during the revolving period, and instead use those principal payments to fund the purchase of new receivables. The occurrence of “early amortization events” may result in termination of the revolving periods of our securitization transactions, which would require us to repay the affected outstanding securitized borrowings out of principal collections without regard to the original payment schedule. Our average level of credit card securitized borrowings was $14.3 billion for the 2013 calendar year and $14.6 billion and $13.5 billion for the 2012 and 2011 fiscal years, respectively. 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 6: 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.

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, including reaffirmation from each of the rating agencies of the security's required rating. Historically, we have exercised this option to shorten the accumulation period to one month prior to maturity. If we were to determine that the payment rate on the underlying receivables would not support a one-month accumulation period, or if one or more of the rating agencies were to require an accumulation period of longer than one month, we would need to begin accumulating principal cash flows earlier than we have historically. A lengthening of the accumulation period would negatively impact our liquidity, requiring management to implement mitigating measures. During periods of significant maturity levels, absent management actions, the lengthening of the accumulation period could materially adversely affect our financial condition.

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

We, along with Discover Bank, are regularly evaluated by the ratings agencies, and their ratings for our long-term debt and other securities, including asset-backed securities issued by our securitization trusts, are based on a number of factors, including our financial strength as well as factors that may not be within our control. The credit ratings of the securities issued by our securitization trusts are regularly evaluated by the rating agencies. The ratings of our asset-backed securities are based on a number of factors, including the quality of the underlying receivables and the credit enhancement structure of the trusts. Downgrades in our ratings or those of 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. Our liquidity portfolio was $11.1 billion at December 31, 2013. 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. Further, we may choose new investments, 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

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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 and our interest expense to increase or decrease, as certain of our assets and liabilities carry interest rates that fluctuate with market benchmarks. External factors such as tapering of the Federal Reserve Stimulus program may cause interest rates to increase. The inability of the Federal Reserve to adjust monetary policy in a timely manner after a prolonged period of injecting liquidity into the economy could result in a steep increase in domestic inflation and a resulting need to rapidly increase interest rates. 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 cost of funding, which would put Discover at a disadvantage as compared to competitors that have less expensive sources of funding.

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 mitigate any higher cost of funds, which could materially reduce earnings. At the same time, our variable rate loan receivables, which are based on the prime market benchmark rate, may not change at the same rate as our floating rate borrowings or may be subject to a cap, subjecting us to basis risk. The majority of our floating rate borrowings and interest rate derivatives are generally based on the one-month LIBOR rate. If the one-month LIBOR rate were to increase without a corresponding increase in the prime rate, our earnings would be negatively impacted. In addition to asset securitizations, we also utilize deposits as a significant source of funds. The majority of our existing certificates of deposit bear interest at fixed rates that do not fluctuate with market benchmarks, and we use derivative instruments to hedge the fixed rates associated with some of these certificates of deposit. However, new deposit issuances are subject to fluctuations in interest rates. Certificates of deposit we issue directly to consumers are subject to early withdrawal penalties, which may not 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, 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 composition of 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 methods 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 2013 calendar year, we increased our quarterly common stock dividend to $0.20 per share and repurchased approximately 5% 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 our results of operations, financial condition, capital levels, cash requirements, future prospects, regulatory approval and other factors. Holders of our shares of common stock are subject to the prior dividend rights of holders of our preferred stock or the depositary 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. Banking laws and regulations and our banking regulators may limit our ability to pay dividends and make share repurchases. For example, our ability to make capital distributions, including our ability to pay dividends or repurchase shares of our stock, is subject to the Federal Reserve's review and non-objection of our annual capital plan. In certain circumstances, we will not be able to make a capital distribution unless the Federal Reserve has approved such distribution. Further, current or future regulatory initiatives may require us to hold more capital in the future. There can be no assurance that we will declare and pay any dividends on our common stock or our preferred stock or repurchase any shares of our stock in the future.

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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 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. Regulatory and other legal restrictions may limit our ability to transfer funds freely, either to or from our subsidiaries. In particular, some of our subsidiaries are subject to laws and regulations that authorize regulatory bodies to block or reduce the flow of funds to the parent holding company, or that prohibit such transfers altogether in certain circumstances. These laws, regulations and rules may hinder our ability to access funds that we may need to make payments on our obligations. Furthermore, as a bank holding company, we may become subject to a prohibition or to limitations on our ability to pay dividends or repurchase our stock as described above. The Federal Reserve and the FDIC have the authority to prohibit or to limit the payment of dividends by the banking organizations they supervise, including us and our bank subsidiaries. For more information, see "Business — Supervision and Regulation — Capital, Dividends and Share Repurchases."
Operational and Other Risk
Our framework and models for managing risks may not be effective in mitigating our risk of loss.
Our risk management framework seeks to mitigate risk and appropriately balance risk and return. We have established processes and procedures intended to identify, measure, monitor and report the types of risk to which we are subject, including credit risk, market risk, liquidity risk, operational risk, legal and compliance risk, and strategic risk. We seek to monitor and control our risk exposure through a framework of policies, procedures, limits and reporting requirements.
Management of our risks in some cases depends upon the use of analytical and/or forecasting models. If the models that we use to mitigate these 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, we may be subject to liability and damage to our reputation.
Our direct banking and network operations rely heavily on the secure processing, storage and transmission of confidential information about us, our customers and third parties with which we do business. Information security risks for financial institutions have increased and are continuing to increase, in part because of the proliferation of new technologies, the use of the internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, activists, hackers and other external parties. Our technologies, systems, networks and software, and those of other financial institutions, have been and are likely to continue to be the target of cyber attacks, malicious code, computer viruses, denial of service attacks, social engineering and physical attacks that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer information), account takeovers, 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 accidental technological failure. 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 security breaches or events of these types, especially because the techniques used change frequently or are not recognized until launched, and because security attacks can originate from a wide variety of sources. As we rely on many third-party service providers and network participants, a security breach or cyber attack affecting one of these third parties could impact us through no fault of our own. Further, 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 increasingly more risk related to security systems 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, and expand our internal usage of web-based products and applications. If our security systems or those of third parties are penetrated or circumvented such that the confidentiality, integrity and availability of information about us, our customers, transactions processed on our

networks 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.

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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 to increase card usage, or to pay the 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