Discover Financial Services
Form 10-Q
July 01, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 31, 2009

OR

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

For the transition period from to

Commission File Number 001-33378

DISCOVER FINANCIAL SERVICES

(Exact name of registrant as specified in its charter)

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

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

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 ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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 ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of June 26, 2009 there were 483,081,101 shares of the registrant s Common Stock, par value $0.01 per share, outstanding.

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DISCOVER FINANCIAL SERVICES

Quarterly Report on Form 10-Q

For the quarterly period ended May 31, 2009

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

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

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

DISCOVER FINANCIAL SERVICES

Consolidated Statements of Financial Condition

	May 31, 2009	November 30, 2008
	(unaudited)	
	(dollars in thousands, except per share amounts)	
Assets		
Cash and due from banks	$ 815,680	$ 793,585
Federal Funds sold		1,050,000
Interest-earning deposits	8,879,145	8,327,558
Cash and cash equivalents	9,694,825	10,171,143
Restricted cash special dividend escrow	427,357	
Investment securities:		
Available-for-sale (amortized cost of $1,491,255 and $1,211,245 at May 31, 2009 and November 30, 2008, respectively)	1,429,738	1,127,119
Held-to-maturity (fair value of $91,796 and $84,167 at May 31, 2009 and November 30, 2008, respectively)	99,682	100,825
Total investment securities	1,529,420	1,227,944
Loan receivables:		
Credit card	25,312,764	23,814,307
Other	2,128,750	1,402,304
Total loan receivables	27,441,514	25,216,611
Allowance for loan losses	(1,986,473)	(1,374,585)
Net loan receivables	25,455,041	23,842,026
Accrued interest receivable	187,662	159,021
Amounts due from asset securitization	1,767,545	2,233,600
Premises and equipment, net	531,166	552,502
Goodwill	255,421	255,421
Intangible assets, net	199,477	203,319
Other assets	1,470,374	1,247,406
Total assets	$ 41,518,288	$ 39,892,382
Liabilities and Stockholders Equity		
Deposits:		
Interest-bearing deposit accounts	$ 29,085,894	$ 28,452,146
Non-interest bearing deposit accounts	63,836	78,375
Total deposits	29,149,730	28,530,521
Short-term borrowings	500,000	500,000
Long-term borrowings	1,427,043	1,735,383
Accrued interest payable	235,934	268,967
Special dividend Morgan Stanley	513,250	473,000
Accrued expenses and other liabilities	2,276,691	2,468,688
Total liabilities	34,102,648	33,976,559
Commitments, contingencies and guarantees (Note 14)		
Stockholders Equity:		

Preferred stock, par value $0.01 per share; 200,000,000 shares authorized; 1,224,558 issued and outstanding at May 31, 2009	1,151,979	
Common stock, par value $0.01 per share; 2,000,000,000 shares authorized; 483,110,566 and 480,517,188 shares issued at May 31, 2009 and November 30, 2008, respectively	4,831	4,805
Additional paid-in capital	3,029,992	2,938,657
Retained earnings	3,296,234	3,046,956
Accumulated other comprehensive loss	(52,542)	(66,338)
Treasury stock, at cost; 1,434,982 and 530,549 shares at May 31, 2009 and November 30, 2008, respectively	(14,854)	(8,257)
Total stockholders equity	7,415,640	5,915,823
Total liabilities and stockholders equity	$ 41,518,288	$ 39,892,382

See Notes to Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES

Consolidated Statements of Income

	For the Three Months Ended May 31,		For the Six Months Ended May 31,	
	2009	2008	2009	2008
	(unaudited) (dollars in thousands, except per share amounts)			
Interest income:				
Credit card loans	$ 781,176	$ 503,755	$ 1,514,675	$ 1,047,744
Other loans	40,641	16,171	75,874	25,403
Federal Funds sold		26,062	3,262	67,341
Investment securities	17,960	11,626	33,544	17,613
Deposits	14,559	34,239	35,059	56,676
Other interest income	3,648	20,210	11,363	60,088
Total interest income	857,984	612,063	1,673,777	1,274,865
Interest expense:				
Deposits	308,123	292,441	605,249	602,240
Short-term borrowings	1,345	45	2,528	135
Long-term borrowings	10,537	20,762	24,948	50,314
Total interest expense	320,005	313,248	632,725	652,689
Net interest income	537,979	298,815	1,041,052	622,176
Provision for loan losses	643,861	210,969	1,581,674	516,601
Net interest income after provision for loan losses	(105,882)	87,846	(540,622)	105,575
Other income:				
Securitization income	325,264	628,031	743,147	1,341,528
Loan fee income	52,293	53,839	120,315	142,097
Discount and interchange revenue	81,894	65,523	157,161	117,419
Fee products	75,248	59,126	150,024	118,459
Merchant fees	11,736	17,849	24,573	36,693
Transaction processing revenue	32,604	30,405	61,470	56,359
Loss on investment securities	(1,012)	(31,280)	(1,817)	(32,464)
Antitrust litigation settlement	472,775		947,616	
Other income	30,318	21,399	68,587	40,345
Total other income	1,081,120	844,892	2,271,076	1,820,436
Other expense:				
Employee compensation and benefits	208,151	218,290	427,639	435,660
Marketing and business development	102,922	132,038	214,355	273,591
Information processing and communications	74,441	79,449	149,338	157,725
Professional fees	74,550	81,392	144,673	155,064
Premises and equipment	18,223	19,803	36,295	39,444
Other expense	82,341	75,853	147,451	147,684
Total other expense	560,628	606,825	1,119,751	1,209,168
Income from continuing operations before income tax expense	414,610	325,913	610,703	716,843
Income tax expense	188,810	124,370	264,509	276,471
Income from continuing operations	225,800	201,543	346,194	440,372
Income (loss) from discontinued operations, net of tax		32,605		(125,010)

Net income		225,800		234,148		346,194		315,362
Preferred stock dividends and accretion of discount		(16,554)				(16,554)		
Net income available to common stockholders	$	209,246	$	234,148	$	329,640	$	315,362
Basic earnings per share:								
Income from continuing operations available to common stockholders	$	0.43	$	0.42	$	0.69	$	0.92
Income (loss) from discontinued operations, net of tax				0.07				(0.26)
Net income available to common stockholders	$	0.43	$	0.49	$	0.69	$	0.66
Diluted earnings per share:								
Income from continuing operations available to common stockholders	$	0.43	$	0.42	$	0.68	$	0.92
Income (loss) from discontinued operations, net of tax				0.06				(0.27)
Net income available to common stockholders	$	0.43	$	0.48	$	0.68	$	0.65
Dividends paid per share of common stock	$	0.02	$	0.06	$	0.08	$	0.12

See Notes to Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES

Consolidated Statements of Changes in Stockholders Equity

	Preferred Stock Shares	Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
					(unaudited) (dollars and shares in thousands)				
Balance at November 30, 2007		$	477,762	$ 4,777	$ 2,846,127	$ 2,717,905	$ 32,032	$ (1,419)	$ 5,599,422
Adoption of FASB Interpretation No. 48						(8,743)			(8,743)
Comprehensive income:									
Net income						315,362			315,362
Foreign currency translation, net of tax							(48,358)		
Net unrealized losses on investment securities, net of tax							(9,103)		
Other comprehensive loss							(57,461)		(57,461)
Total comprehensive income									257,901
Purchases of treasury stock								(2,986)	(2,986)
Common stock issued under employee benefit plans			1,138	12	16,125				16,137
Common stock issued and stock-based compensation expense			709	7	46,559				46,566
Dividends						(58,471)			(58,471)
Other					(135)				(135)
Balance at May 31, 2008		$	479,609	$ 4,796	$ 2,908,676	$ 2,966,053	$ (25,429)	$ (4,405)	$ 5,849,691
Balance at November 30, 2008		$	480,517	$ 4,805	$ 2,938,657	$ 3,046,956	$ (66,338)	$ (8,257)	$ 5,915,823
Adoption of the measurement date provision of FASB Statement No. 158, net of tax						(1,110)			(1,110)
Comprehensive income:									
Net income						346,194			346,194
Adjustments related to investment securities, net of tax							14,035		
Adjustments related to pension and postretirement, net of tax							(239)		
Other comprehensive income							13,796		13,796
Total comprehensive income									359,990
Purchases of treasury stock								(6,597)	(6,597)
Common stock issued under employee benefit plans			99	1	665				666
Common stock issued and stock based compensation expense			2,495	25	24,417	120			24,562
Income tax deficiency on stock-based compensation plans					(9,614)				(9,614)
Issuance of preferred stock	1,225	1,148,691			75,867				1,224,558
Accretion of preferred stock discount		3,288				(3,288)			
Dividends preferred stock						(13,266)			(13,266)
Dividends paid common stock						(39,122)			(39,122)
Special dividend Morgan Stanley						(40,250)			(40,250)

Balance at May 31, 2009	1,225	$ 1,151,979	483,111	$ 4,831	$ 3,029,992	$ 3,296,234	$ (52,542)	$ (14,854)	$ 7,415,640

See Notes to Consolidated Financial Statements.

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DISCOVER FINANCIAL SERVICES

Consolidated Statements of Cash Flows

	For the Six Months Ended May 31, 2009	2008
	(unaudited) (dollars in thousands)	
Cash flows from operating activities		
Net income	$ 346,194	$ 315,362
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on sale of Goldfish business		152,060
Loss on investments securities	1,817	32,464
Gain on equipment	(63)	
Stock-based compensation expense	25,228	62,703
Income tax deficiency on stock-based compensation expense	(9,614)	
Deferred income taxes	(242,929)	(22,867)
Depreciation and amortization on premises and equipment	49,134	55,621
Other depreciation and amortization	(5,329)	60,801
Provision for loan losses	1,581,674	536,612
Amortization of deferred revenues	(3,321)	(9,350)
Changes in assets and liabilities:		
(Increase) decrease in amounts due from asset securitization	466,055	333,254
(Increase) decrease in other assets	(57,352)	(47,866)
Increase (decrease) in accrued expenses and other liabilities	(237,916)	97,472
Net cash provided by operating activities	1,913,578	1,566,266
Cash flows from investing activities		
Proceeds from the sale of Goldfish business		69,529
Maturities of investment securities	79,975	28,706
Purchases of investment securities	(353,822)	(20,367)
Proceeds from securitization and sale of loans held for investment	750,000	4,394,802
Net principal disbursed on loans held for investment	(3,896,894)	(4,802,649)
(Increase) decrease in restricted cash special dividend escrow	(427,357)	
Proceeds from sale of equipment	1,513	
Purchases of premises and equipment	(29,932)	(45,434)
Net cash (used for) investing activities	(3,876,517)	(375,413)
Cash flows from financing activities		
Proceeds from the issuance of preferred stock and warrant	1,224,558	
Net increase (decrease) in short-term borrowings		(759,312)
Repayment of long-term debt and bank notes	(307,719)	(243,642)
Purchases of treasury stock	(6,597)	(2,986)
Net increase (decrease) in deposits	626,046	59,820
Dividends paid on common and preferred stock	(49,667)	(58,471)
Net cash provided by (used for) financing activities	1,486,621	(1,004,591)
Effect of exchange rate changes on cash and cash equivalents		(24,592)
Net increase (decrease) in cash and cash equivalents	(476,318)	161,670
Cash and cash equivalents, at beginning of period	10,171,143	8,787,095
Cash and cash equivalents, at end of period	9,694,825	$ 8,948,765

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:				
Cash paid during the period for:				
Interest expense	$	643,667	$	718,970
Income taxes, net of income tax refunds	$	298,877	$	129,020
Non-cash transactions:				
Special dividend Morgan Stanley	$	(40,250)	$	
Acquisition of certificated beneficial interests in DCENT	$		$	585,000

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

(unaudited)

1. Background and Basis of Presentation

Description of Business. Discover Financial Services (DFS or the Company) is a leading credit card issuer and electronic payment services company. In the second quarter of 2009, the Company became a bank holding company under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act, which subjects the Company to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the Federal Reserve). The Company provides its services through its main subsidiaries Discover Bank and DFS Services LLC, the latter of which, directly or through its subsidiaries, operates Discover s signature card network (the Discover Network), the PULSE Network (PULSE) and Diners Club International (Diners Club). Discover Bank is a Delaware state-chartered bank that offers its customers a variety of credit card, other consumer loan and deposit products. Discover Network operates a credit card transaction processing network for Discover Card-branded and third-party issued credit cards. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE network with access to ATMs, as well as point of sale terminals at retail locations throughout the U.S. for debit card transactions. Diners Club is a global payments network that offers transaction processing and marketing services to licensees globally.

The Company s business segments are U.S. Card and Third-Party Payments. The U.S. Card segment includes Discover Card-branded credit cards issued to individuals and small businesses on the Discover Network and other consumer products and services, including personal loans, student loans, prepaid cards and other consumer lending and deposit products offered through the Company s Discover Bank subsidiary. The Third-Party Payments segment includes the PULSE Network, Diners Club and the Company s third-party issuing business.

Basis of Presentation. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, the financial statements reflect all adjustments which are necessary for a fair presentation of the results for the quarter. All such adjustments are of a normal, recurring nature. The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and related disclosures. Actual results could differ from these estimates. These interim consolidated financial statements should be read in conjunction with the Company s 2008 audited consolidated and combined financial statements filed with the Company s annual report on Form 10-K for the year ended November 30, 2008.

Recently Issued Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets-an amendment of FASB Statement No. 140* (Statement No. 166) and Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* (Statement No. 167). Statement No. 166 amends the accounting for transfers of financial assets, and is the principal accounting guidance governing the Company s credit card asset securitization activities. Under Statement No. 166, the Discover Card Master Trust I and Discover Card Execution Note Trust (the trusts) used in the Company s securitization transactions will no longer be exempt from consolidation. Statement No. 167 prescribes an ongoing assessment of the Company s involvements in the activities of the trusts and its rights or obligations to receive benefits or absorb losses of the trusts that could be potentially significant in order to determine whether those entities will be required to be consolidated on the Company s financial statements. The assessment under Statement No. 167 will result in the consolidation of the trusts by the Company. As a result, credit card receivables held by the securitization trusts and debt issued from those entities will be presented as assets and liabilities of the Company beginning on the effective date of the new standards. The two standards become effective for the Company on December 1, 2009. Initial adoption is expected to have a material impact on the Company s reported financial condition. If the trusts were consolidated using the carrying amounts of trust assets and liabilities as of May 31, 2009, this would result in an increase in total assets of approximately $21.1 billion and an increase in total liabilities of approximately $22.3 billion on the Company s balance sheet, with the difference of approximately $1.2 billion recorded as a charge to retained earnings, net of tax. In addition, certain interests in the trust assets currently reflected on the Company s balance sheet will be reclassified, primarily to loan receivables, cash and accrued interest receivable. After adoption, the Company s results of operations will no longer reflect securitization income, but will instead report interest income and provisions for loan losses associated with all managed loan receivables and interest expense associated with debt issued from the trusts. Because the Company s securitization transactions will be accounted for under the new accounting standards as secured borrowings rather than asset sales, the presentation of cash flows from these transactions will be presented as cash flows from financing activities rather than cash flows from investing activities.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (Statement No. 165). This standard incorporates into authoritative accounting literature certain guidance that already existed within generally accepted auditing standards, but the rules concerning recognition and disclosure of subsequent events will remain essentially unchanged. Subsequent events guidance addresses events which occur after the balance sheet date but before the issuance of financial statements. Under Statement No. 165 as under current practice, an entity must record the effects of subsequent events that provide evidence about conditions that existed at the balance sheet date and must disclose but not record the effects of subsequent events which provide evidence about conditions that did not exist at the balance sheet date. This Statement is effective for interim and annual periods ending after June 15, 2009. The adoption of Statement No. 165 is not expected to have a material impact on the Company s financial condition, results of operations or cash flows.

In April 2009, the FASB issued FASB Staff Position (FSP) No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). This FSP provides guidance for estimating fair value under FASB Statement No. 157, *Fair Value Measurements* when the volume and level of activity for the asset or liability have significantly decreased. This FSP also provides guidance for identifying circumstances that indicate a transaction is not orderly. This FSP affirms that the objective of fair value measurement in a market for an asset that is not active is the price that would be received in an orderly (i.e., not distressed) transaction on the measurement date under current market conditions. If the market is determined to be not active, the entity must consider all available evidence in determining whether an observable transaction is orderly. If a quoted price is determined to be associated with a distressed transaction, the entity should place little, if any, weight on that transaction price in estimating fair value or market risk premiums. The FSP is effective for interim and annual periods ending after June 15, 2009. The application of this guidance is not expected to have a material impact on the Company s financial condition, results of operations or cash flows.

In April 2009, the FASB issued FASB Staff Position No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2 and FAS 124-2). This FSP changes existing guidance for determining whether an impairment of a debt security is other than temporary. Under this guidance, impairment of a debt security is separated into two components: impairment related to credit loss and impairment related to all other factors. When an entity does not intend to sell the security and it is more likely than not that the entity will not have to sell the security before recovery of its fair value up to its cost basis, it will recognize the credit component of an other-than-temporary impairment in earnings and the remaining portion in other comprehensive income. Alternatively, if the entity intends to sell the security or concludes that it is more likely than not that it will have to sell the security before recovery of its cost basis, the entire impairment will be recorded in earnings. The FSP requires separate display of credit and noncredit losses on the income statement. The FSP is effective for interim and annual periods ending after June 15,

2009. The application of this guidance is not expected to have a material impact on the Company s financial condition, results of operations or cash flows.

In April 2009, the FASB issued FASB Staff Position No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP FAS 107-1 and APB 28-1). This FSP requires quarterly disclosure of the methods and significant assumptions used to estimate the fair values of all financial instruments within the scope of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, which were previously required only in annual financial statements. The FSP is effective for interim and annual periods ending after June 15, 2009. The application of this guidance affects disclosures only; therefore it will have no impact on the Company s financial condition, results of operations or cash flows.

In December 2008, the FASB issued FASB Staff Position 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets* (FSP FAS 132(R)-1). FSP FAS 132(R)-1 provides guidance on an employer s disclosures about plan assets of a defined benefit pension or other postretirement plan. Required disclosures include how investment allocation decisions are made, the inputs and valuation techniques used to measure the fair value of plan assets and significant concentrations of risk. The FSP is effective for fiscal years ending after December 15, 2009. The application of this guidance will only affect disclosures and therefore will not impact the Company s financial condition, results of operations or cash flows.

In June 2008, the FASB issued FASB Staff Position No. EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* (FSP EITF 03-6-1), which addresses whether unvested equity-based awards are participating securities and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method described in FASB Statement No. 128, *Earnings per Share*. FSP EITF 03-6-1 is effective for the Company beginning December 1, 2009 and cannot be adopted early. All prior period earnings per share data presented in financial statements that are issued after the effective date shall be adjusted retrospectively to conform to the new guidance. The adoption of FSP EITF 03-6-1 will not impact the Company s financial condition, results of operations or cash flows.

2. Discontinued Operations

On March 31, 2008, the Company sold its Goldfish credit card business, based in the United Kingdom and previously reported as the International Card segment, to Barclays Bank PLC. The aggregate sale price under the agreement was £35 million (which was equivalent to approximately $70 million), which was paid in cash at closing.

The following table provides summary financial information for discontinued operations related to the sale of the Company s Goldfish business (dollars in thousands):

	For the Three Months Ended May 31, 2008	For the Six Months Ended May 31, 2008
Revenues[(1)]	$ 29,791	$ 128,355
Income from discontinued operations	$ 21,282	$ 44,912
Gain (loss) on the sale of discontinued operations[(2)]	14,800	(220,830)
Pretax income (loss) from discontinued operations	36,082	(175,918)
Income tax expense (benefit)	3,477	(50,908)
Income (loss) from discontinued operations, net of tax	$ 32,605	$ (125,010)

(1) Revenues are the sum of net interest income and other income.
(2) Gain (loss) on the sale of discontinued operations for the three and six months ended May 31, 2008 includes a $27.1 million realization of cumulative foreign currency translation adjustments which were previously recorded net of tax. As a result, there is no tax impact in the period of sale related to the realization of cumulative foreign currency translation adjustments.

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3. Investment Securities

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

	May 31, 2009	November 30, 2008
U.S. Treasury and other U.S. government agency obligations	$ 14,983	$ 16,495
States and political subdivisions of states	70,150	70,290
Other securities:		
Certificated retained interests in DCENT	977,357	981,742
Credit card asset-backed securities of other issuers	393,608	85,762
Asset-backed commercial paper notes	58,758	59,586
Other debt and equity securities	14,564	14,069
Total other securities	1,444,287	1,141,159
Total investment securities	$ 1,529,420	$ 1,227,944

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At May 31, 2009				
Available-for-Sale Investment Securities[(1)]				
Certificated retained interests in DCENT	$ 1,065,000	$	$ (87,643)	$ 977,357
Credit card asset-backed securities of other issuers	367,482	26,128	(2)	393,608
Asset-backed commercial paper notes	58,758			58,758
Equity securities[(2)]	15			15
Total available-for-sale investment securities	$ 1,491,255	$ 26,128	$ (87,645)	$ 1,429,738
Held-to-Maturity Investment Securities[(3)]				
U.S. Treasury and other U.S. government agency obligations:				
Mortgage-backed securities	$ 14,484	$ 664	$	$ 15,148
Other	499			499
Total U.S. Treasury and other U.S. government agency obligations	14,983	664		15,647
States and political subdivisions of states	70,150		(8,550)	61,600
Other debt securities	14,549			14,549
Total held-to-maturity investment securities	$ 99,682	$ 664	$ (8,550)	$ 91,796

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
At November 30, 2008				
Available-for-Sale Investment Securities[1]				
Certificated retained interests in DCENT	$ 1,065,000	$	$ (83,258)	$ 981,742
Credit card asset-backed securities of other issuers	85,843	627	(708)	85,762
Asset-backed commercial paper notes	59,586			59,586
Equity securities[2]	816		(787)	29
Total available-for-sale investment securities	$ 1,211,245	$ 627	$ (84,753)	$ 1,127,119
Held-to-Maturity Investment Securities[3]				
U.S. Treasury and other U.S. government agency obligations:				
Mortgage-backed securities	$ 15,449	$ 379	$	$ 15,828
Other	1,046	2		1,048
Total U.S. Treasury and other U.S. government agency obligations	16,495	381		16,876
States and political subdivisions of states	70,290	93	(17,132)	53,251
Other debt securities	14,040			14,040
Total held-to-maturity investment securities	$ 100,825	$ 474	$ (17,132)	$ 84,167

(1) Available-for-sale investment securities are reported at fair value.
(2) For the six months ended May 31, 2009 and May 31, 2008, the Company recorded other-than-temporary impairments of $0.8 million and $1.2 million respectively, related to an equity investment classified as available-for-sale.
(3) Held-to-maturity investment securities are reported at amortized cost.

Certificated retained interests in Discover Card Execution Note Trust (DCENT) are certificated Class B and Class C notes issued by DCENT, which the Company now holds as other retained beneficial interests. For more information on the fair value calculations of these investment securities, see Note 15: Fair Value Disclosures. The changes in the fair value of available-for-sale investment securities are recorded in other comprehensive income, net of tax. During the three and six months ended May 31, 2009, the Company recorded a $0.2 million reduction of gross realized losses and $4.4 million of gross unrealized losses, respectively, and no unrealized gains through other comprehensive income on these investment securities. During the three and six months ended May 31, 2008, the Company recorded $2.7 million and $14.7 million of gross unrealized losses, respectively, and no unrealized gains through other comprehensive income on these investment securities.

Credit card asset-backed securities of other issuers are investments in third-party credit card asset-backed securities which the Company began purchasing in the fourth quarter of 2008. During the three months ended May 31, 2009, the Company recorded $21.1 million of gross unrealized gains and a $0.8 million reduction to gross unrealized losses through other comprehensive income on these investment securities. During the six months ended May 31, 2009, the Company recorded $25.5 million of gross unrealized gains and a $0.7 million reduction of gross unrealized losses through other comprehensive income on these investment securities.

At May 31, 2009, the Company had $8.6 million of net unrealized losses on its held-to-maturity investment securities in states and political subdivisions of states, compared to $17.0 million of net unrealized losses at November 30, 2008. The Company believes the unrealized loss on these investments is the result of changes in interest rates subsequent to the Company s acquisitions of these securities and that the reduction in value is temporary. Additionally, the Company expects to collect all amounts due according to the contractual terms of these securities.

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4. Loan Receivables

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

	May 31, 2009	November 30, 2008
Credit card loans:		
Discover Card(1)	$ 24,858,933	$ 23,348,134
Discover Business Card	453,831	466,173
Total credit card loans	25,312,764	23,814,307
Other consumer loans:		
Personal loans	1,241,465	1,028,093
Student loans	816,177	299,929
Other	71,108	74,282
Total other consumer loans	2,128,750	1,402,304
Total loan receivables	27,441,514	25,216,611
Allowance for loan losses	(1,986,473)	(1,374,585)
Net loan receivables	$ 25,455,041	$ 23,842,026

(1) Amount includes $15.1 billion and $14.8 billion of the Company s seller s interest in credit card securitizations at May 31, 2009 and November 30, 2008, respectively. See Note 5: Credit Card Securitization Activities for further information.

Activity in the allowance for loan losses is as follows (dollars in thousands):

	For the Three Months Ended May 31,		For the Six Months Ended May 31,	
	2009	2008	2009	2008
Balance at beginning of period	$ 1,878,942	$ 860,378	$ 1,374,585	$ 759,925
Additions:				
Provision for loan losses	643,861	210,969	1,581,674	516,601
Deductions:				
Charge-offs	(588,920)	(269,013)	(1,070,199)	(514,641)
Recoveries	52,590	44,441	100,413	84,890
Net charge-offs	(536,330)	(224,572)	(969,786)	(429,751)
Balance at end of period	$ 1,986,473	$ 846,775	$ 1,986,473	$ 846,775

Information regarding net charge-offs of interest and fee revenues on credit card loans is as follows (dollars in thousands):

	For the Three Months Ended May 31,		For the Six Months Ended May 31,	
	2009	2008	2009	2008
Interest accrued subsequently charged off, net of recoveries (recorded as a reduction of interest income)	$ 137,561	$ 62,153	$ 248,941	$ 119,126

Loan fees accrued subsequently charged off, net of recoveries (recorded as a reduction to other income)	$ 49,694	$ 26,916	$ 90,848	$ 50,985

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Information regarding loan receivables that are over 90 days delinquent and accruing interest and loan receivables that are not accruing interest is as follows (dollars in thousands):

	May 31, 2009	November 30, 2008
Loans over 90 days delinquent and accruing interest	$ 569,766	$ 444,324
Loans not accruing interest	$ 274,000	$ 173,123

5. Credit Card Securitization Activities

The Company has accessed the term asset securitization market through the Discover Card Master Trust I and, beginning July 26, 2007, DCENT, into which credit card loan receivables generated in the U.S. Card segment are transferred and from which beneficial interests are issued to investors. The Company continues to own and service the accounts that generate the transferred loan receivables. The Discover Card Master Trust I debt structure consists of Class A, triple-A rated certificates and Class B, single-A rated certificates held by third parties, with credit enhancement provided by the subordinated Class B certificates and a cash collateral account. DCENT includes up to four classes of securities sold to investors, the most senior class generally receiving a triple-A rating. In this structure, in order to issue senior, higher rated, classes of notes, it is necessary to obtain the appropriate amount of credit enhancement, generally through the issuance of junior, lower rated classes of notes. These trusts are not subsidiaries of the Company, and as such, are excluded from the consolidated financial statements in accordance with GAAP. The Company s securitization activities generally qualify as sales under GAAP and accordingly are not treated as secured financing transactions. As such, credit card loan receivables equal to the amount of the investors interests in transferred loan receivables are removed from the consolidated statements of financial condition.

The Company s retained interests in credit card asset securitizations include an undivided seller s interest, certain subordinated tranches of notes, accrued interest receivable on securitized credit card loan receivables, cash collateral accounts, servicing rights, the interest-only strip receivable and other retained interests. The undivided seller s interest is not represented by security certificates and is reported in loan receivables. The Company s undivided seller s interest ranks *pari passu* with investors interests in the securitization trusts. The remaining retained interests are subordinate to certain investors interests and, as such, may not be realized by the Company if needed to absorb deficiencies in cash flows that are allocated to the investors of the trusts. Subordinated retained interests represented by a security are recorded in available-for-sale investment securities at amounts that approximate fair value, with changes in the fair value estimates recorded in other comprehensive income, net of tax. All other subordinated retained interests are recorded in amounts due from asset securitization at amounts that approximate fair value. Changes in the fair value estimates of these other subordinated retained interests are recorded in securitization income. For more information on the fair value calculations of these retained interests, see Note 15: Fair Value Disclosures.

In addition to changes in fair value estimates, securitization income also includes annual servicing fees received by the Company and excess servicing income earned on the transferred loan receivables from which beneficial interests have been issued. Annual servicing fees are based on a percentage of the monthly investor principal balance outstanding and approximate adequate compensation to the Company for performing the servicing. Accordingly, the Company does not recognize servicing assets or servicing liabilities for these servicing rights. Failure to service the transferred loan receivables in accordance with contractual requirements may lead to a termination of the servicing rights and the loss of future servicing fees.

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The following table summarizes the Company s retained interests in credit card securitizations (dollars in thousands):

	May 31, 2009	November 30, 2008
Available-for-sale investment securities	$ 977,357	$ 981,742
Loan receivables (seller s interest)[1]	15,134,552	14,831,938
Amounts due from asset securitization:		
Cash collateral accounts[2]	959,123	1,121,447
Accrued interest receivable	425,278	473,694
Interest-only strip receivable	94,670	300,120
Other subordinated retained interests	275,814	315,823
Other	12,660	22,516
Amounts due from asset securitization	1,767,545	2,233,600
Total retained interests	$ 17,879,454	$ 18,047,280

(1) Loan receivables net of allowance for loan losses were $14.0 billion at May 31, 2009 and November 30, 2008.

(2) $0.9 billion and $1.0 billion at May 31, 2009 and November 30, 2008, respectively, are pledged as security against a long-term borrowing. See Note 8: Long-Term Borrowings.

The Company s retained interests are subject to credit, payment and interest rate risks on the transferred credit card loan receivables. To protect investors, the securitization structures include certain features that could result in earlier-than-expected repayment of the securities, which could cause the Company to sustain a loss of one or more of its retained interests and could prompt the need for the Company to seek alternative sources of funding. The primary investor protection feature relates to the availability and adequacy of cash flows in the securitized pool of receivables to meet contractual requirements, the insufficiency of which triggers early repayment of the securities. The Company refers to this as the economic early amortization feature. Investors are allocated cash flows derived from activities related to the accounts comprising the securitized pool of receivables, the amounts of which reflect finance charges billed, certain fee assessments, allocations of discount and interchange, and recoveries on charged off accounts. From these cash flows, investors are reimbursed for charge-offs occurring within the securitized pool of receivables and receive a contractual rate of return and the Company is paid a servicing fee as servicer. Any cash flows remaining in excess of these requirements are paid to the Company and recorded as excess spread, included in securitization income on the Company s consolidated statements of income. An excess spread of less than 0% for a contractually specified period, generally a three month average, would trigger an economic early amortization event. Once the excess spread falls below 0%, the receivables that would have been subsequently purchased by the trust from the Company will instead continue to be recognized on the Company s statement of financial condition since the cash flows generated in the trust would be used to repay principal to investors. Such an event could result in the Company incurring losses related to its subordinated retained interests, including amounts due from asset securitization and available-for-sale investment securities. The investors and the securitization trusts have no recourse to the Company s other assets for a shortage in cash flows.

Another feature, which is applicable only to the notes issued from DCENT, is one in which excess cash flows generated by the transferred loan receivables are held at the trust for the benefit of the investors, rather than paid to the Company. This reserve account funding is triggered when DCENT s three month average excess spread rate decreases to below 4.50% with increasing funding requirements as excess spread levels decline below preset levels to 0%. Similar to economic early amortization, this feature also is designed to protect the investors interests from loss.

In addition to performance measures associated with the transferred credit card loan receivables, there are other events or conditions which could trigger an early amortization event. As of May 31, 2009, no economic or other early amortization events have occurred. In addition, excess spread rates have been in excess of levels which would require excess cash flows to be held at the trust and not paid to the Company.

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The table below provides information concerning investors interests and related excess spreads at May 31, 2009 (dollars in thousands):

	Investors Interests	# of Series Outstanding	3-Month Rolling Average Excess Spread
Interchange series[(1)]	$ 11,915,795	14	6.00%
Non-interchange series[(2)]	2,789,475	3	2.94%
Discover Card Master Trust I	14,705,270	17	
Discover Card Execution Note Trust[(1)]	8,615,000	20	4.65%
Total Company	$ 23,320,270	37	

(1) Discover Card Master Trust I certificates issued on or after November 4, 2004 and all notes issued by DCENT include cash flows derived from discount and interchange revenue earned by Discover Bank.

(2) The non-interchange series are not part of DCENT and are therefore not subject to the 4.50% excess spread trigger that requires cash to be held at the trust.

During the three and six months ended May 31, 2009, the Company recognized net revaluation losses on subordinated retained interests, principally the interest-only strip receivable, of $93.0 million and $191.2 million, respectively, in securitization income in the consolidated statements of income. During both periods, these net revaluation losses included $1.0 million of initial gains on new securitizations transactions, net of issuance discounts, as applicable. For the three and six months ended May 31, 2008, the Company recorded net revaluation losses of $44.5 million and net revaluation gains of $30.5 million, respectively, which included initial gains on new securitization transactions, net of issuance discounts, as applicable, of $25.3 million and $62.1 million, respectively.

The following table summarizes certain cash flow information related to the securitized pool of loan receivables (dollars in millions):

	For the Three Months Ended May 31,		For the Six Months Ended May 31,	
	2009	2008	2009	2008
Proceeds from third-party investors in new credit card securitizations	$ 750	$ 1,846	$ 750	$ 4,395
Proceeds from collections reinvested in previous credit card securitizations	$ 11,579	$ 14,297	$ 21,605	$ 28,436
Contractual servicing fees received	$ 113	$ 138	$ 237	$ 275
Cash flows received from retained interests	$ 364	$ 737	$ 997	$ 1,456
Purchases of previously transferred credit card loan receivables (securitization maturities)	$	$ 1,151	$ 2,989	$ 4,967

Key estimates used in measuring the fair value of the interest-only strip receivable at the date of securitization that resulted from credit card securitizations completed during the six months ended May 31, 2009 and 2008 were as follows:

	For the Six Months Ended May 31,		
	2009	2008	
Weighted average life (in months)	1.8	4.3	5.1
Payment rate (rate per month)	17.18%	19.60%	19.80%
Principal charge-offs (rate per annum)	9.66%	5.10%	5.42%
Discount rate (rate per annum)	16.00%	12.00%	

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Key estimates and the sensitivity of the reported fair value of the interest-only strip receivable to immediate 10% and 20% adverse changes in those estimates were as follows (dollars in millions):

	May 31, 2009	November 30, 2008
Interest-only receivable strip (carrying amount/fair value)	$ 95	$ 300
Weighted average life (in months)	4.7	4.6
Weighted average payment rate (rate per month)	17.18%	18.52%
Impact on fair value of 10% adverse change	$ (4)	$ (21)
Impact on fair value of 20% adverse change	$ (8)	$ (39)
Weighted average principal charge-offs (rate per annum)	9.66%	6.83%
Impact on fair value of 10% adverse change	$ (51)	$ (55)
Impact on fair value of 20% adverse change	$ (86)	$ (110)
Weighted average discount rate (rate per annum)	16.00%	12.50%
Impact on fair value of 10% adverse change	$ (1)	$ (1)
Impact on fair value of 20% adverse change	$ (2)	$ (3)
Cash collateral accounts (carrying amount/fair value)	$ 959	$ 1,121
Weighted average discount rate (rate per annum)	2.12%	2.59%
Impact on fair value of 10% adverse change	$ (4)	$ (7)
Impact on fair value of 20% adverse change	$ (9)	$ (13)
Certificated retained beneficial interests (carrying amount/fair value)	$ 977	$ 982
Weighted average discount rate (rate per annum)	13.09%	10.29%
Impact on fair value of 10% adverse change	$ (12)	$ (13)
Impact on fair value of 20% adverse change	$ (23)	$ (25)

The sensitivity analyses of the interest-only strip receivable, cash collateral accounts and certificated retained beneficial interests are hypothetical and should be used with caution. Changes in fair value based on a 10% or 20% variation in an estimate generally cannot be extrapolated because the relationship of the change in the estimate to the change in fair value may not be linear. Also, the effect of a variation in a particular estimate on the fair value of the interest-only strip receivable, specifically, is calculated independent of changes in any other estimate; in practice, changes in one factor may result in changes in another (for example, increases in market interest rates may result in lower payments and increased charge-offs), which might magnify or counteract the sensitivities. In addition, the sensitivity analyses do not consider any action that the Company may take to mitigate the impact of any adverse changes in the key estimates.

The table below presents quantitative information about total and average amounts outstanding, delinquencies and net principal charge-offs associated with credit card loan receivables that are managed by the Company (managed loans), that have been derecognized (securitized loans) and that continue to be recognized in the Company s statements of financial position (owned loans) as required by FASB Statement of Financial Account Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* as amended (dollars in millions):

	May 31, 2009	November 30, 2008
Loans Outstanding:		
Managed credit card loans	$ 48,904	$ 49,693
Less: Securitized credit card loans	23,591	25,879
Owned credit card loans	$ 25,313	$ 23,814
Loans Over 30 Days Delinquent:		
Managed credit card loans	$ 2,559	$ 2,317
Less: Securitized credit card loans	1,256	1,234
Owned credit card loans	$ 1,303	$ 1,083

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	For the Three Months Ended May 31, 2009	For the Three Months Ended May 31, 2008	For the Six Months Ended May 31, 2009	For the Six Months Ended May 31, 2008
Average Loans:				
Managed credit card loans	$ 49,108	$ 46,857	$ 49,675	$ 47,668
Less: Securitized credit card loans	22,875	27,581	23,503	27,461
Owned credit card loans	$ 26,233	$ 19,276	$ 26,172	$ 20,207
Net Principal Charge-offs:				
Managed credit card loans	$ 988	$ 595	$ 1,808	$ 1,121
Less: Securitized credit card loans	467	371	863	692
Owned credit card loans	$ 521	$ 224	$ 945	$ 429

6. Deposits

The Company s deposits consist of brokered and direct-to-consumer certificates of deposit, deposit products offered through affinity relationships, money market deposit accounts and deposits payable upon demand. Brokered certificates of deposit are issued and distributed through several wealth management firms, one of which is Morgan Stanley. These wealth management firms distribute certificates of deposit both through their own clients and other wealth management firms and brokers known as a selling group. As of May 31, 2009 and November 30, 2008, $9.4 billion and $11.7 billion, respectively, of the Company s certificates of deposit had been distributed through Morgan Stanley and its selling group.

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

	May 31, 2009	November 30, 2008
Certificates of deposit in amounts less than $100,000[(1)]	$ 22,568,632	$ 22,083,962
Certificates of deposit in amounts of $100,000[(1)] or greater	2,483,863	1,808,320
Savings deposits, including money market deposit accounts	4,033,399	4,559,864
Total interest-bearing deposits	$ 29,085,894	$ 28,452,146
Average annual interest rate	4.22%	4.67%

(1) Represents the basic insurance amount covered by the FDIC. Effective May 20, 2009, the standard insurance amount of $250,000 per depositor is in effect through December 31, 2013.

At May 31, 2009, certificates of deposit maturing over the next five years and thereafter were as follows (dollars in thousands):

Year	Amount
2009	$ 3,657,492
2010	$ 6,883,798
2011	$ 4,564,097
2012	$ 3,936,960
2013	$ 3,750,734
Thereafter	$ 2,259,414

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7. Short-Term Borrowings

Short-term borrowings consist of term and overnight Federal Funds purchased and other short-term borrowings with original maturities less than one year. The following table identifies the balances and weighted average interest rates on short-term borrowings outstanding at period end (dollars in thousands):

	May 31, 2009		November 30, 2008	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
Other short-term borrowings[1]	$ 500,000	0.25%	$ 500,000	0.60%

(1) Other short-term borrowings consist of amounts borrowed under the Federal Reserve s Term Auction Facility. The Company was required to pledge $0.8 billion and $0.7 billion of loan receivables against this borrowing as of May 31, 2009 and November 30, 2008, respectively.

8. Long-Term Borrowings

Long-term borrowings consist of borrowings and capital leases having original maturities of one year or more. The following table provides a summary of the outstanding amounts and general terms of the Company s long-term borrowings (dollars in thousands):

	May 31, 2009		November 30, 2008		Interest Rate	
Funding source	Outstanding	Interest Rate	Outstanding	Interest Rate	Terms	Maturity
Bank notes	$		$ 249,977	2.54%	3-month LIBOR[1] + 15 basis points	February 2009
Secured borrowings	624,737	1.02%	682,456	3.05%	Commercial paper rate + 50 basis points	December 2010[2]
Unsecured borrowings:						
Floating rate senior notes	400,000	1.86%	400,000	3.35%	3-month LIBOR + 53 basis points	June 2010
Fixed rate senior notes	399,345	6.45%	399,304	6.45%	6.45% fixed	June 2017
Total unsecured borrowings	799,345		799,304			
Capital lease obligations	2,961	6.26%	3,646	6.26%	6.26% fixed	Various
Total long-term borrowings	$ 1,427,043		$ 1,735,383			

(1) London Interbank Offered Rate (LIBOR).

(2) Repayment is dependent upon the available balances of the cash collateral accounts at the various maturities of underlying securitization transactions, with final maturity in December 2010.

The Company has entered into an unsecured credit agreement that is effective through May 2012. The agreement provides for a revolving credit commitment of up to $2.4 billion (of which the Company may borrow up to 30% and Discover Bank may borrow up to 100% of the total commitment). As of May 31, 2009, the Company had no outstanding balances due under the facility. The credit agreement provides for a commitment fee on the unused portion of the facility, which can range from 0.07% to 0.175% depending on the index debt ratings. Loans outstanding under the credit facility bear interest at a margin above the Federal Funds rate, LIBOR, the EURIBOR or the Euro Reference rate. The terms of the credit agreement include various affirmative and negative covenants, including financial covenants related to the maintenance of certain capitalization and tangible net worth levels, and certain double leverage, delinquency and Tier 1 capital to managed loans ratios. The credit agreement also includes customary events of default with corresponding grace periods, including, without limitation, payment defaults, cross-defaults to other agreements evidencing indebtedness for borrowed money and bankruptcy-related defaults. The commitment may be terminated upon an event of default.

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9. Preferred Stock

On March 13, 2009, the Company issued and sold to the United States Department of the Treasury (the U.S. Treasury) under the U.S. Treasury s Capital Purchase Program (CPP) (i) 1,224,558 shares of the Company s Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the senior preferred stock) and (ii) a ten-year warrant to purchase 20,500,413 shares of the Company s common stock, par value $0.01 per share, for an aggregate purchase price of $1.225 billion. The senior preferred stock, which qualifies as Tier 1 capital, has a per share liquidation preference of $1,000, and pays a cumulative dividend rate of 5% per year for the first five years and a rate of 9% per year beginning May 15, 2014. The warrant has a 10-year term and was immediately exercisable upon issuance, with an exercise price, subject to anti-dilution adjustments, equal to $8.96 per share of common stock. Of the aggregate amount of $1.225 billion received, approximately $1.15 billion was attributable to preferred stock and approximately $75 million was attributable to the warrant based on the relative fair values of these instruments on the date of issuance.

As the senior preferred stock was initially valued at $1.15 billion, the difference between the initial value and the par value of the stock will be accreted over a period of five years through a reduction to retained earnings on an effective yield basis. While this accretion will not impact net income, it, along with the dividends, will reduce the amount of income available to common stockholders, and thus will reduce both basic and diluted earnings per share.

The senior preferred stock is generally non-voting, other than class voting rights on certain matters that could amend the rights of or adversely affect the stock. The senior preferred stock terms provide that the stock may not be redeemed, as opposed to repurchased, prior to May 15, 2012 unless the Company has received aggregate gross proceeds from one or more qualified equity offerings (as described below) of at least $306 million. In such a case, the Company may redeem the senior preferred stock, in whole or in part, subject to the approval of the Federal Reserve, upon notice, up to a maximum amount equal to the aggregate net cash proceeds received by the Company from such qualified equity offerings. A qualified equity offering is a sale and issuance for cash by the Company, to persons other than the Company or its subsidiaries after March 13, 2009, of shares of perpetual preferred stock, common stock or a combination thereof, that in each case qualify as Tier 1 capital at the time of issuance under the applicable risk-based capital guidelines of the Federal Reserve. On or after May 15, 2012, the senior preferred stock may be redeemed by the Company at any time, in whole or in part, subject to the approval of the Federal Reserve and notice requirements.

Notwithstanding the foregoing, pursuant to a letter agreement between the Company and the U.S. Treasury, the Company is permitted, after obtaining the approval of the Federal Reserve, to repay the senior preferred stock at any time, and when such senior preferred stock is repaid, the U.S. Treasury is required to liquidate the warrant, all in accordance with The American Recovery and Reinvestment Act of 2009, as it may be amended from time to time, and any rules and regulations thereunder. The U.S. Treasury may transfer the senior preferred stock to a third party at any time. The U.S. Treasury may only transfer or exercise an aggregate of one half of the shares of common stock underlying the warrant prior to the earlier of the redemption of all of the shares of senior preferred stock and December 31, 2009.

Participation in the CPP restricts the Company s ability to increase dividends on its common stock or to repurchase its common stock until three years have elapsed, unless (i) all of the senior preferred stock issued to the U.S Treasury is redeemed, (ii) all of the senior preferred stock issued to the U.S Treasury has been transferred to third parties, or (iii) the Company receives the consent of the U.S. Treasury. Participation in the CPP has required the Company to adopt the U.S. Treasury s standards for executive compensation and corporate governance for the period during which the U.S. Treasury holds equity issued under the CPP.

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10. Employee Benefit Plans

The Company sponsors defined benefit pension and other postretirement plans for its eligible U.S. employees; however, in October 2008, the Company announced to its employees the discontinuation of the accrual of future benefits in its defined benefit pension plans effective December 31, 2008. For more information, see the Company s annual report on Form 10-K for the year ended November 30, 2008.

Net periodic benefit (income) cost recorded by the Company included the following components (dollars in thousands):