

## **DISCOVER FINANCIAL SERVICES**

### **Basel III Regulatory Capital Disclosures**

**For the Quarterly Period Ended March 31, 2022**

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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" refers to Discover Financial Services and its subsidiaries.

## Disclosure Road Map

The following table provides page references for disclosures within the Company's Quarterly Report on Form 10-Q and Annual Report on Form 10-K relating to topics addressed in this Basel III disclosure report:

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## Overview

### Introduction

Discover Financial Services ("DFS" or the "Company") is a digital banking and payment services company. The Company was incorporated in Delaware in 1960. The Company is a bank holding company ("BHC") under the Bank Holding Company Act of 1956 and a financial holding company under the Gramm-Leach-Bliley Act. Therefore, the Company is subject to oversight, regulation and examination by the Board of Governors of the Federal Reserve System (the "Federal Reserve"). The Company provides digital banking products and services and payment services through its subsidiaries. The Company offers credit card loans, private student loans, personal loans, home loans and deposit products to its customers. The Company also operates the Discover Network, the PULSE network ("PULSE") and Diners Club International ("Diners Club"), collectively known as the Discover Global Network. The Discover Network processes transactions for Discover-branded credit and debit cards and provides payment transaction processing and settlement services. PULSE operates an electronic funds transfer network, providing financial institutions issuing debit cards on the PULSE network with access to ATMs domestically and internationally and merchant acceptance throughout the United States of America ("U.S.") for debit card transactions. Diners Club is a global payments network of licensees, which are generally financial institutions, that issue Diners Club branded credit and charge cards and/or provide card acceptance services.

The Company's banking subsidiary, Discover Bank, offers credit card loans, private student loans, personal loans and home loans. Discover Bank also offers 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. Discover Bank 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.

### Basel III and Regulatory Capital Disclosure Report

DFS and Discover Bank are subject to regulatory capital rules issued by the Federal Reserve and FDIC, respectively, under the Basel Committee's December 2010 framework ("Basel III rules"). Under the Basel III rules, DFS and Discover Bank are classified as "standardized approach" entities.

The Basel III rules establish a more risk-sensitive approach to capital management and require the Company to publicly disclose certain qualitative and quantitative information regarding its capital structure and adequacy, credit risk and related mitigation policies, securitizations, equity exposures, operational risk and other matters. The qualitative and quantitative information included are commonly referred to as the "Pillar 3 Disclosures." The U.S. regulators have required the Pillar 3 Disclosures with an expressed objective of improving market discipline and encouraging sound risk management practices. This report provides the required disclosures or references to other publicly-available documents where they are located and includes information on the methodologies used to calculate risk-weighted assets ("RWAs"). See Note 11: Capital Adequacy in the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2022 ("1Q22 Form 10-Q") for a detailed discussion of the Basel III requirements.

This report should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2021 ("2021 Form 10-K"), 1Q22 Form 10-Q, Federal Reserve report form FR Y-9C for the year-to-date period ended March 31, 2022, and Discover Bank's Call Report ("Call Report") for the year-to-date period ended March 31, 2022, which include essential information on risk management policies and practices and regulatory capital ratios. In addition, this document contains a disclosure road map.

## Scope of Application

### Basis of Consolidation

The basis of consolidation used for regulatory reporting is the same as that used under accounting principles generally accepted in the U.S. ("GAAP"). See Note 1: Background and Basis of Presentation in the 2021 Form 10-K for details on the Company's principles of consolidation.

### Capital in Subsidiaries

Discover Bank is the Company's only depository institution subsidiary. At March 31, 2022, the Company did not have any subsidiaries whose regulatory capital was less than the minimum required regulatory capital amount. The Company does not have any insurance subsidiaries subject to the Basel III rules.

### Restrictions on Capital

The Federal Reserve requires a BHC to inform and consult with the Federal Reserve before declaring and paying any dividends that would cause an institution to become inadequately capitalized. The declaration and payment of future dividends are subject to the discretion of the Company's board of directors and the Federal Reserve's non-objection to the Company's capital plan. Banking laws and regulations and DFS' banking regulators may limit or prohibit the payment of dividends on, or DFS' repurchase of, DFS' stock at any time. As a result, there can be no assurance that DFS will declare and pay any dividends on or repurchase DFS stock in the future. At March 31, 2022, DFS was "well-capitalized" as defined in the Federal Reserve's Regulation Y.

The amount and size of any future dividends and share repurchases will depend on the Company's results of operations, financial condition, capital levels, cash requirements, future prospects, regulatory review and other factors as further described in "Business — Supervision and Regulation — Capital, Dividends and Share Repurchases" in the 2021 Form 10-K. Holders of the Company's shares of common stock are subject to the prior dividend rights of holders of the Company's preferred stock or the depository shares representing such preferred stock outstanding. No dividend may be declared or paid or set aside for payment on the Company's common stock if dividends have not been declared and paid in full on all outstanding shares of preferred stock in any dividend period.

DFS, the parent holding company, depends on dividends, distributions and other payments from its subsidiaries, notably Discover Bank, to fund dividend payments; share repurchases; payments on its obligations, including debt obligations; and provide funding and capital as needed to its operating subsidiaries. However, banking laws and regulations and DFS' banking regulators may limit or prohibit the transfer of funds freely, either to or from the Company's subsidiaries, at any time. As a result, these laws, regulations and rules may hinder DFS' ability to access funds that it may need to make payments on its obligations or otherwise achieve its strategic objectives. For more information, see "Business — Supervision and Regulation — Capital, Dividends and Share Repurchases" in the 2021 Form 10-K.

The Federal Deposit Insurance Act ("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 established by regulation. At March 31, 2022, Discover Bank met all applicable requirements to be deemed "well-capitalized" under the prompt corrective action rules and corresponding FDIC requirements.

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. For more information on FDIA regulations, see "Business — Supervision and Regulation — FDIA" in the 2021 Form 10-K.

## Capital Structure

### Regulatory Capital Instruments

The Company's regulatory capital instruments consist of common stock, preferred stock and subordinated debt. The following table presents components of the Company's capital structure on a transitional basis (dollars in millions):

	March 31, 2022
Common stock	\$ 6
Additional paid-in capital	4,390
Retained earnings	27,444
Accumulated other comprehensive loss ("AOCI")	(213)
Treasury stock	(17,639)
Common shareholder's equity	13,988
Less: Deductions for goodwill and intangible assets, net of deferred tax liabilities	255
Less: Deductions for AOCI related adjustments	(213)
Common equity tier 1 ("CET1")	13,946
Non-cumulative perpetual preferred stock	1,056
Tier 1 capital	15,002
Qualifying subordinated debt	495
Other elements of tier 2 capital <sup>(1)</sup>	1,227
Tier 2 capital	1,722
Total capital	\$ 16,724

(1) Represents the portion of the allowance for credit losses that is included in Tier 2 capital, which is limited to 1.25% of RWAs.

On March 27, 2020, federal bank regulatory agencies announced an interim and now final rule that allows banks that have implemented the Current Expected Credit Losses ("CECL") accounting model to delay the estimated impact of CECL on regulatory capital for two years, followed by a three-year transition period. For purposes of calculating regulatory capital, the Company elected to defer recognition of the estimated impact of CECL on regulatory capital for two years in accordance with the final rule; after that period of deferral, which ended December 31, 2021, the estimated impact of CECL on regulatory capital will be phased in over three years beginning in 2022. The phase-in of the CECL accounting model decreased CET1 by \$537 million as of January 1, 2022. The Company estimates that electing this option raised the Company's CET1 capital ratios in 2020, 2021 and 2022. The Company's CET1 capital ratios will continue to be favorably impacted by this election over the phase-in period.

Refer to Note 7: Preferred Stock and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources — Capital" in the 1Q22 Form 10-Q and Note 12: Common and Preferred Stock in the 2021 Form 10-K for more information related to the terms and conditions of the Company's common and preferred stock.

The following table presents the terms and conditions of the Company's qualifying subordinated debt (dollars in millions):

At March 31, 2022	Issuance Date	Interest Rate	Interest Rate Terms	Maturity	Par
Discover Bank					
Subordinated banknotes due 2028	August 9, 2018	4.68 %	Fixed	August 9, 2028	\$ 500

The subordinated debt is subject to a Basel III provision limiting its amount included on the BHC level. That limitation is imposed on capital instruments issued by a consolidated bank subsidiary of the BHC as the availability of this capital might be limited to the BHC.

## **Regulatory Capital Ratios**

See Note 11: Capital Adequacy in the 1Q22 Form 10-Q and Schedule HC-R in the 1Q22 report form FR Y-9C for the Company's capital ratios and related components as of March 31, 2022.

## **Capital Adequacy**

### **Capital Planning and Management**

The Company's capital planning and management framework is designed to ensure that the Company maintains sufficient capital consistent with its risk profile and all applicable regulatory standards and guidelines. The framework encompasses forecasting capital levels, establishing capital targets, monitoring capital adequacy against targets, maintaining appropriate contingency capital plans and identifying strategic options to deploy excess capital.

Under the Federal Reserve's regulatory tailoring framework, DFS is considered a Category IV institution and therefore subject to the least stringent category of enhanced prudential standards for bank holding companies with at least \$100 billion in assets. Among other things, DFS is subject to supervisory stress tests every other year rather than annually, is no longer subject to regulations requiring submission of company-run capital stress tests and is no longer subject to the liquidity coverage ratio. However, DFS is still required to submit annual capital plans to the Federal Reserve based on forward-looking internal analysis of income and capital levels under expected and stressful conditions. Further, DFS remains subject to other core components of enhanced prudential standards, such as risk management and risk committee requirements and liquidity risk management regulations.

See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Regulatory Environment and Developments" and "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources" in the 1Q22 Form 10-Q for more information.

## Standardized Approach Risk-Weighted Assets

RWAs are an institution's assets and off-balance-sheet exposures, weighted according to the risk categories prescribed in the Basel III rules. The percentage of RWAs is used to determine minimum capital requirements.

The following table presents components of DFS' RWAs in accordance with the standardized approach, subject to transitional provisions (dollars in millions):

	March 31, 2022
<b>On-balance sheet:</b>	
Exposure to depository institutions and foreign banks	\$ 348
Exposures to government-sponsored entities ("GSEs") and public sector entities	35
Credit card loan receivables	72,844
Private student and personal loan receivables	17,150
Residential mortgage exposure	2,017
Retail exposure	92,011
Past-due exposure <sup>(1)</sup>	1,264
Equity exposures	691
Other exposures <sup>(2)</sup>	3,754
<b>Off-balance sheet:</b>	
Off-balance sheet commitments	75
Allowance for credit losses excluded from RWAs	(3,369)
Total standardized RWAs	<u>\$ 94,809</u>

(1) Includes loans that are 90 or more days past-due and non-accruing loans.

(2) Includes \$163 million of business card receivables that are classified as commercial loans under regulatory guidelines.

## Risk-Based Capital Ratios

See Note 11: Capital Adequacy in the 1Q22 Form 10-Q for CET1, tier 1 and total risk-based capital ratios as of March 31, 2022, as calculated under the Basel III standardized approach framework for DFS and Discover Bank.

## Capital Conservation Buffer and Stress Capital Buffer

Under the Basel III rules, the Company and its bank subsidiary must maintain a capital conservation buffer ("CCB") to not be subject to any limitations on distributions of capital or discretionary bonus payments. The CCB is a complementary requirement to the Prompt Corrective Action framework described in the Basel III rules. The CCB is equal to the lowest of the reported CET1, Tier 1, or total capital ratios, minus the minimum capital requirement for each respective ratio.

The CCB for BHCs was previously fixed at 2.5%. On March 4, 2020, the Federal Reserve announced the SCB final rule, which imposes limitations on DFS' capital distributions if DFS does not maintain its risk-based capital ratios above stated regulatory minimum ratios based on the results of supervisory stress tests. Under this rule, DFS is required to assess whether DFS' planned capital actions are consistent with the effective capital distribution limitations that will apply on a pro-forma basis throughout the planning horizon. The SCB requirement is institution-specific and replaces the fixed 2.5% CCB for BHCs. The SCB is calculated as the greater of (i) 2.5% and (ii) the sum of (a) the difference between DFS' actual CET1 ratio at the beginning of the forecast and the projected minimum CET1 ratio based on the Federal Reserve's models in its nine-quarter Severely Adverse stress scenario, plus (b) the sum of the dollar amount of DFS' planned common stock dividend distributions for each of the fourth through seventh quarters of its nine-quarter capital planning horizon, as a percentage of RWAs. For Category IV firms, including DFS, the Federal Reserve calculates each firm's SCB biennially in



even-numbered calendar years, and did so in 2022. In odd-numbered years, each firm subject to Category IV standards that did not opt-in to such year's supervisory stress tests as part of the Federal Reserve's Comprehensive Capital and Analysis Review (CCAR) process receives an adjusted SCB requirement that is updated to reflect its planned common stock dividends per the firm's annual capital plan. DFS elected to not participate in the Federal Reserve's supervisory stress test in 2021, but will be a participant in 2022. On August 5, 2021, the Federal Reserve notified DFS of its adjusted SCB requirement of 3.6% based on the planned common stock dividends in the 2021 Capital Plan. DFS' SCB was effective beginning on October 1, 2021, and slightly increased from DFS' SCB in effect for the preceding year, which was 3.5%.

As part of CCAR, DFS is required to submit an annual capital plan, which it did prior to the April 5, 2022 due date ("2022 Capital Plan"). This 2022 Capital Plan employed forward-looking internal assessments of income and capital under baseline and stressful conditions. For additional information related to the results of the Federal Reserve's supervisory stress tests and SCB, see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources" in the 1Q22 Form 10-Q.

The SCB final rule does not apply to Discover Bank. The CCB for Discover Bank continues to be fixed at 2.5%. The Company and its bank subsidiary maintained a buffer of capital sufficient to meet the SCB and CCB requirements, respectively, as of March 31, 2022. See Schedule HC-R Part I in the 1Q22 report form FR Y-9C for DFS' CCB. See Schedule RC-R Part I in the 1Q22 Call Report for Discover Bank's CCB.

The Company's eligible retained income at March 31, 2022, was \$1.4 billion. The Company is not subject to any limitations on distributions and discretionary bonus payments resulting from the CCB framework.

## Credit Risk: General Disclosures

### Credit Risk Management Objectives and Policies

Credit risk management is a critical component of the Company's 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 the Company. The Company's credit risk from consumer lending products is generally highly diversified across millions of accounts without significant individual exposures. The Company manages credit risk primarily based on customer segments and product types. See "Business — Credit Risk Management" and "Business — Risk Management" in the 2021 Form 10-K for more information regarding how the Company defines and manages credit and other risks.

### Past-due Loans

See Note 2: Summary of Significant Accounting Policies in the 2021 Form 10-K for the Company's significant accounting policies regarding past-due loans, non-accrual loans and charge offs of uncollectible amounts.

### Allowance for Credit Losses

See Note 2: Summary of Significant Accounting Policies in the 2021 Form 10-K for the Company's significant accounting policies regarding the allowance for credit losses.

### Credit Risk Exposures

The following table presents the major types of on- and off-balance sheet credit exposure and average credit exposure relevant to the Company (dollars in millions):

	March 31, 2022	QTD Average Balance
Cash and cash equivalents <sup>(1)</sup>	\$ 1,737	\$ 1,954
Loans held for investment ("LHFI") <sup>(2)</sup>	\$ 93,471	\$ 92,691
Unused commitments <sup>(3)</sup>	\$ 222,340	\$ 221,789
Debt securities	\$ 5,977	\$ 6,509

(1) Excludes cash held with the Federal Reserve.

(2) Includes credit card, private student, personal and other loans.

(3) Primarily relates to credit cards.

Virtually all of the Company's unused commitments are unconditionally cancellable at any time and receive zero conversion factor for risk-based capital calculations.

The following table presents the geographic distribution of the LHF and unused commitments (dollars in millions)<sup>(1)</sup>:

<b>At March 31, 2022</b>	<b>LHF<sup>(2)</sup></b>	<b>Unused commitments<sup>(3)</sup></b>
California	\$ 8,071	\$ 20,525
Texas	7,883	17,894
New York	6,681	14,240
Florida	6,243	15,749
Pennsylvania	5,062	11,899
Illinois	4,943	11,985
Ohio	3,877	9,806
New Jersey	3,609	8,098
Georgia	2,857	6,191
Michigan	2,663	6,490
Other	41,582	99,463
<b>Total</b>	<b>\$ 93,471</b>	<b>\$ 222,340</b>

(1) The company originates loans throughout the U.S. The geographic region is classified based on the domicile of the borrower.

(2) Includes credit card, private student, personal and other loans.

(3) Primarily relates to credit cards.

All debt securities held by the Company were issued by domestic parties. The Company held \$50 million of cash and cash equivalents in accounts outside the U.S. as of March 31, 2022.

The following table presents the distribution of credit exposures by counterparty type (dollars in millions):

<b>At March 31, 2022</b>	<b>Retail</b>	<b>Sovereign (including GSEs)</b>	<b>Banks &amp; Brokerage companies<sup>(1)</sup></b>	<b>Other</b>
Cash and cash equivalents <sup>(1)</sup>	\$ —	\$ —	\$ 1,737	\$ —
LHF <sup>(2)</sup>	\$ 93,254	\$ —	\$ —	\$ 217
Unused commitments <sup>(3)</sup>	\$ 221,436	\$ —	\$ —	\$ 904
Debt securities	\$ —	\$ 5,977	\$ —	\$ —
Loans 90 or more days past-due and non-accruing	\$ 29	\$ —	\$ —	\$ —
Loans 90 or more days past-due and accruing	\$ 647	\$ —	\$ —	\$ 1

(1) Excludes cash held with the Federal Reserve.

(2) Includes credit card, private student, personal and other loans.

(3) Primarily relates to credit cards.

The following table presents the remaining contractual maturity delineation of the retail LHF portfolio<sup>(1)</sup> (dollars in millions):

	<b>March 31, 2022</b>
One year or less	\$ 65,003
Over one year through five years	\$ 14,150
Over five years	\$ 14,105

(1) Includes fixed-rate credit cards in the "over one year through five years" classification per Call Report guidelines and excludes loans in non-accrual status.

See the following references to the Company's 1Q22 Form 10-Q for quantitative information regarding credit risk exposures, which are presented in accordance with U.S. GAAP.

#### *Loan Receivables*

- See Note 3: Loan Receivables for information on outstanding loans, non-accrual loans, delinquent loans, as well as charge offs during the period. The Company does not identify past-due loans by significant geographic area.

#### *Allowance for Credit Losses*

- See Note 3: Loan Receivables for a reconciliation of changes in the allowance for credit losses.

### **Counterparty Credit Risk-Related Exposures: General Disclosures**

#### **Counterparty Credit Risk Exposures**

With respect to derivatives, counterparty credit risk is the risk that the counterparty to a derivative transaction could default before the final settlement of the transaction's cash flows. The Company's counterparty credit risk from derivatives arises primarily from interest rate swap transactions and foreign exchange forward transactions. For non-cleared transactions, the Company has master netting arrangements and minimum collateral posting thresholds with its derivative counterparties for its fair value and cash flow hedge interest rate swaps and foreign exchange forward contracts. For cleared transactions, the Company trades through clearing members of a central counterparty ("CCP") exchange such that all positions traded through the CCP clearing member are netted and collateralized pursuant to the rules of the exchange. As a result, certain cash collateral amounts associated with derivative positions that are cleared through a CCP exchange are legally characterized as settlement of the derivative positions and are reflected as offsets to the associated derivatives balances recorded in other assets or accrued expenses and other liabilities, instead of as collateral in other assets or deposits. For more information on the Company's derivatives, including the counterparty credit risk-related exposures, see Note 15: Derivatives and Hedging Activities in the 1Q22 Form 10-Q.

With respect to securities repurchase and reverse repurchase transactions, counterparty credit risk is the risk that the counterparty to a transaction could default before the securities and cash (plus interest) in the transaction have been returned to their original owners. For securities repurchase and reverse repurchase transactions, the Company's counterparty credit risk arises from its use of agreements with major broker-dealer counterparties or central banks using primarily U.S. Treasury and/or agency securities as collateral.

#### **Methodology Used to Assign Counterparty Credit Limits**

The process for approving a counterparty's credit risk exposure limit is guided by (i) core credit policies, (ii) procedures and standards and (iii) the experience and judgment of credit risk professionals. The process applies to all investment and hedging activities conducted by the Company's Treasury group and includes determining the maximum potential exposure to each counterparty after considering market volatility, netting agreements and collateral support as appropriate.

Internal ratings are assigned to each counterparty and reflect a range of factors, including the counterparty's financial condition, the strength of its management, the counterparty's business profile and the regulatory environment facing the counterparty. The Company considers these factors in setting counterparty credit exposure limits, which drive internal approval levels.

Credit risk analysts conduct daily monitoring of exposures versus limits with any resulting issues escalated to risk officers and senior management in accordance with established policies.

#### **Policies for Securing, Valuing and Managing Collateral and Establishing Credit Reserves**

The Company's policies and procedures cover the management and governance of financial assets (including securing and valuing collateral) utilized to mitigate counterparty credit risk. Specifically, the Company's Corporate Risk Management group considers standard eligibility criteria and market value haircuts for any collateral used to reduce estimated net exposures in the Company's transactions. In addition, industry-standard legal agreements combined with internal reviews for legal enforceability are employed to ensure that the Company's rights to collateral are appropriately protected.

The Company monitors the market value of the collateral regularly where the collateral offsets the estimated exposure. The Company's Treasury group has procedures for managing margin calls to maintain an appropriate level of collateral coverage in light of market value fluctuations and CCP exchange rules. The Company reconciles trades daily, consistent with regulatory guidance and industry best practices, and margin dispute processes are in place. These margining processes and the regular monitoring of exposures mitigate the counterparty credit risk arising from derivative transactions and securities repurchase and reverse repurchase transactions.

### **Primary Types of Collateral for Derivatives Exposures**

Cleared transactions are cash-settled daily, with cash and U.S. Treasury securities used to meet daily margin requirements, per CCP exchange rules. The net open exposure of non-cleared derivative transactions is secured using cash collateral and U.S. Treasury securities.

### **Credit Risk Mitigation**

As part of its risk management activities, the Company uses various risk mitigants to manage portions of the credit risk in its portfolios. Credit risk mitigation is important to the Company in effectively managing its credit risk exposures. Credit card receivables comprise a majority of the Company's assets, with unfunded commitments that are unconditionally cancellable.

Loans secured by 1-4 family residential properties is the sole asset category of the Company that benefits from collateral to reduce capital requirements. As of March 31, 2022, RWAs were reduced by \$401 million due to collateral held against those loans, which represented 0.42% of the total RWAs and had an immaterial impact on the Company's capital ratios.

As of March 31, 2022, the Company does not utilize credit derivatives as a risk mitigation tool.

### **Securitization**

#### **Securitization Activities**

The Company engages in credit card and private student loan securitization activities. The Company's securitizations are accounted for as secured borrowings, and the related trusts are treated as consolidated subsidiaries of the Company. The assets of the Company's consolidated securitization trusts are restricted from being sold or pledged as collateral for other borrowings. The cash flows from these restricted assets may be used only to pay obligations of the trusts. The related debt issued by all securitization trusts is reported primarily in long-term borrowings.

The Company accesses the term asset securitization market through the Discover Card Master Trust I ("DCMT") and the Discover Card Execution Note Trust ("DCENT"). Credit card loan receivables are transferred into DCMT, and beneficial interests in DCMT are transferred into DCENT. DCENT issues debt securities to investors. Credit card and private student loan trust receivables underlying third-party investors' interests are recorded in credit card loan receivables and private student loan receivables, respectively. See Note 4: Credit Card and Private Student Loan Securitization Activities in the 1Q22 Form 10-Q for more information on the Company's credit card and private student loan securitization activities.

The total outstanding principal amount of assets securitized by the Company does not meet operational criteria as defined in the Basel III rules. As a result, the underlying assets are reconsolidated in the balance sheet and accordingly risk-weighted based on their balance sheet classification for Basel III purposes. In addition, the Company did not hold investments in asset-backed securities subject to Basel III securitization disclosure requirements as of March 31, 2022. As a result, Table 8 of disclosure requirements under section 217.63 does not apply to the Company at this time.

## Equities Not Subject to Market Risk Rule

### Overview

The Company makes investments in equities with objectives of (i) generating capital gains, (ii) fostering strategic relationships and (iii) fulfilling Community Reinvestment Act requirements.

The following table presents the carrying value and fair value of the Company's equity investments (dollars in millions):

<u>At March 31, 2022</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Equity investments <sup>(1)</sup>	\$ 709	\$ 709

(1) Includes \$272 million of equity investments that are publicly traded.

There were cumulative realized gains from sales and liquidations of \$26 million during the three months ended March 31, 2022. There were no net unrealized gains or losses that have not been recognized on the consolidated statement of financial condition or through earnings or that were included in tier 1 and tier 2 capital.

Refer to Note 14: Fair Value Measurements in the 1Q22 Form 10-Q for more information related to the Company's methodologies regarding the valuation of equity investments. Refer to Note 2: Investments in the 1Q22 Form 10-Q for more information related to the Company's accounting for equity investments.

### Risk Weighting

The Company utilizes different approaches in calculating RWAs for equity exposures not subject to market risk capital rules. Under the Simplified Risk-Weight Approach ("SRWA"), different types of equity exposures are assigned specific risk weights between 0 percent and 600 percent. The adjusted carrying value for each type of equity exposure is multiplied by the prescribed risk weight. The adjusted carrying value for an on-balance sheet exposure is the carrying value of the exposure. Although the SRWA assigns specific risk weights to different types of equity exposures, the final rule allows "non-significant equity exposures" to be risk-weighted at 100 percent. Equity investments are non-significant if the aggregate adjusted carrying value of the exposures does not exceed 10 percent of a banking organization's total capital. As DFS' total equity exposure was below the 10 percent threshold of March 31, 2022, the Company assigned a risk-weighting of 100 percent for each non-significant equity exposures.

The Alternative Modified Look-Through Approach is used to calculate RWA amounts for equity exposures to investment funds. Using the Alternative Modified Look-Through Approach, the adjusted carrying value of an equity exposure to an investment fund is assigned on a pro-rata basis to the different risk weight categories based on the investment limits in the fund's prospectus, partnership agreement, or similar contract that defines the fund's permissible investments. It is assumed the fund invests to the maximum extent permitted under its investment limits in the exposure type with the highest applicable risk weight and continues to make investments in the order of the exposure type with the next highest applicable risk weight until the maximum total investment is reached.

The following table presents the Company's equity exposures not subject to the Basel III market risk capital rule, using the SRWA and the Alternative Modified Look-Through Approach (dollars in millions):

<u>At March 31, 2022</u>	<u>Risk Weight %</u>	<u>Exposure</u>	<u>RWAs</u>
Community development equity exposure	100%	\$ 377	\$ 377
Non-significant equity exposure	100%	310	310
Federal home loan bank exposure	20%	5	1
Modified look-through		17	3
Total equity exposure not subject to the Basel III market risk capital rule		<u>\$ 709</u>	<u>\$ 691</u>

### Interest Rate Risk for Non-Trading Activities

See "Quantitative and Qualitative Disclosures About Market Risk" in the 1Q22 Form 10-Q for information on the Company's interest rate risk related to non-trading activities.