



2Q16 Financial Results

July 19, 2016

Notice

The following slides are part of a presentation by Discover Financial Services (the "Company") in connection with reporting quarterly financial results and are intended to be viewed as part of that presentation. No representation is made that the information in these slides is complete. For additional financial, statistical, and business related information, as well as information regarding business and segment trends, see the earnings release and financial supplement included as exhibits to the Company's Current Report on Form 8-K filed today and available on the Company's website (www.discover.com) and the SEC's website (www.sec.gov).

The information provided herein includes certain non-GAAP financial measures. The reconciliations of such measures to the comparable GAAP figures are included at the end of this presentation, which is available on the Company's website and the SEC's website.

The presentation contains forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date on which they are made, which reflect management's estimates, projections, expectations or beliefs at that time, and which are subject to risks and uncertainties that may cause actual results to differ materially. For a discussion of certain risks and uncertainties that may affect the future results of the Company, please see "Special Note Regarding Forward-Looking Statements," "Risk Factors," "Business – Competition," "Business – Supervision and Regulation" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, and under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2016, which are filed with the SEC and available at the SEC's website (www.sec.gov). The Company does not undertake to update or revise forward-looking statements as more information becomes available.

2Q16 Summary Financial Results

(\$MM, except per share data)	2Q16	2Q15	B / (W)	
			\$ Δ	% Δ
Revenue Net of Interest Expense	\$2,216	\$2,175	\$41	2%
Provision for Loan Losses	412	306	(106)	(35%)
Operating Expense	906	927	21	2%
Direct Banking	868	914	(46)	(5%)
Payment Services	30	28	2	7%
Total Pre-Tax Income	898	942	(44)	(5%)
Pre-Tax, Pre-Provision Income ⁽¹⁾	1,310	1,248	62	5%
Income Tax Expense	282	343	61	18%
Net Income	<u>\$616</u>	<u>\$599</u>	<u>\$17</u>	<u>3%</u>
ROE	22%	21%		
Diluted EPS	\$1.47	\$1.33	\$0.14	11%
One-time tax benefit⁽²⁾	\$44			
EPS impact from one-time tax benefit	\$0.11			

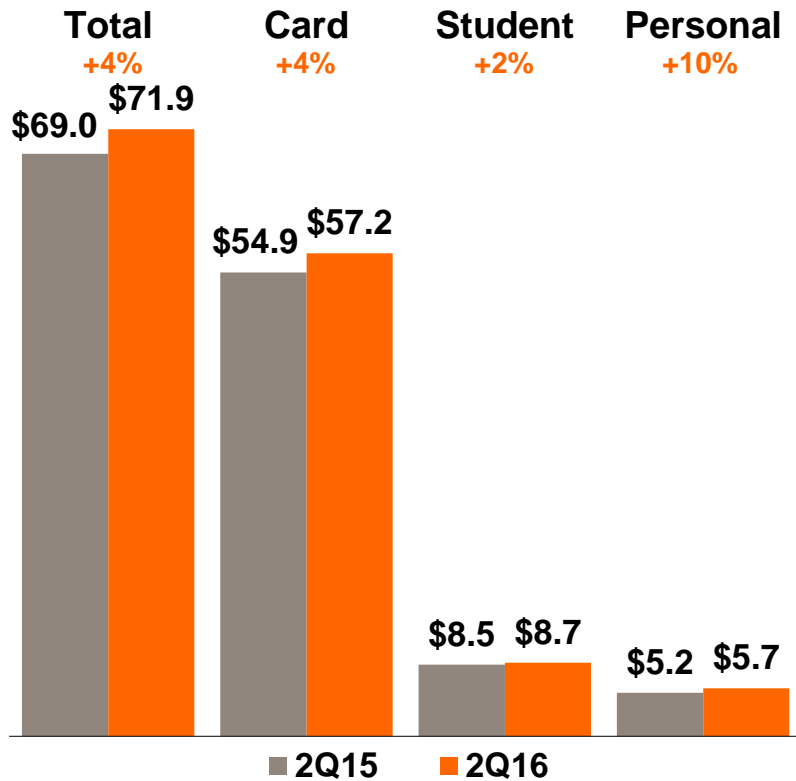
- Diluted EPS of \$1.47, up 11% YOY including a non-recurring tax benefit of \$0.11 per share
- Revenue net of interest expense of \$2.2Bn, up 2% YOY as higher net interest income was partially offset by higher rewards expense and the lack of mortgage income
- Provision for loan losses increased \$106MM, or 35% due primarily to a \$28MM reserve build vs. a reserve release in the prior year
- Expenses decreased \$21MM, or 2%, as the elimination of mortgage expenses was partially offset by higher regulatory and compliance costs

Note(s)

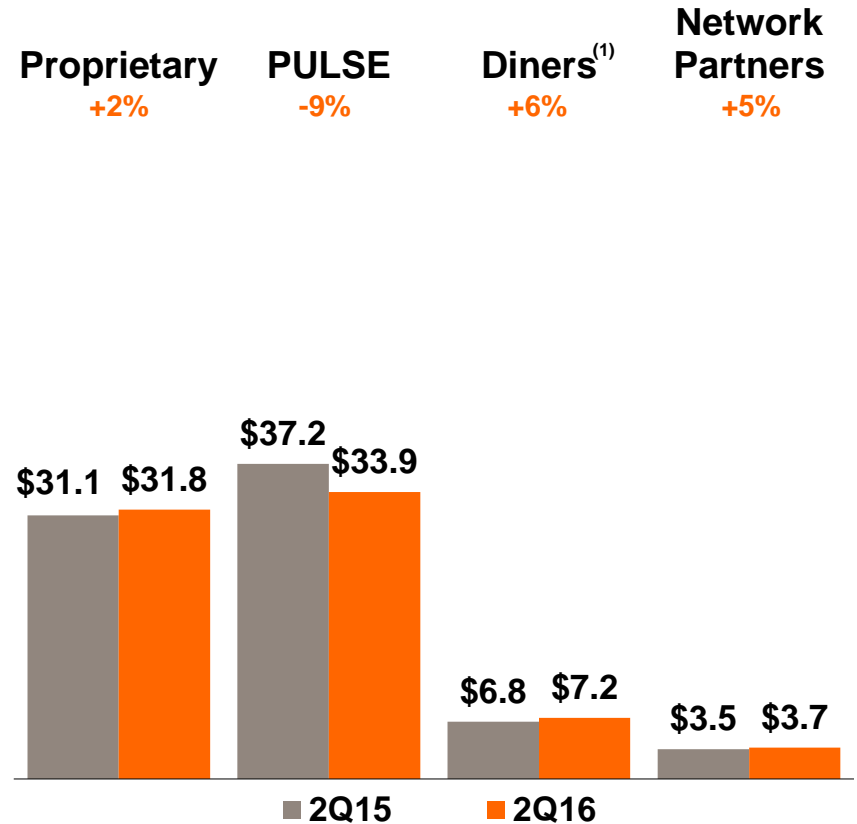
1. Pre-tax, pre-provision income, which is derived by adding provision for loan losses to pre-tax income, is a non-GAAP financial measure which should be viewed in addition to, and not as a substitute for, the Company's reported results. Management believes this information helps investors understand the effect of provision for loan losses on reported results and provides an alternate presentation of the Company's performance; see appendix for a reconciliation
2. Notable item that management believes to be non-recurring related to the resolution of certain tax matters

2Q16 Loan and Volume Growth

Ending Loans (\$Bn)



Volume (\$Bn)



Total Payments Volume down 3% YOY

Note(s)
 1. Volume is derived from data provided by licensees for Diners Club branded cards issued outside of North America and is subject to subsequent revision or amendment

2Q16 Revenue Detail

(\$MM)	2Q16	2Q15	B / (W)	
			\$ Δ	% Δ
Interest Income	\$2,090	\$1,947	\$143	7%
Interest Expense	339	311	(28)	(9%)
Net Interest Income	1,751	1,636	115	7%
Discount/Interchange Revenue	636	612	24	4%
Rewards Cost	371	314	(57)	(18%)
Net Discount/Interchange Revenue	265	298	(33)	(11%)
Protection Products Revenue	59	68	(9)	(13%)
Loan Fee Income	79	80	(1)	(1%)
Transaction Processing Revenue	39	40	(1)	(3%)
Other Income	23	53	(30)	(57%)
Total Non-Interest Income	465	539	(74)	(14%)
Revenue Net of Interest Expense	<u>\$2,216</u>	<u>\$2,175</u>	<u>\$41</u>	<u>2%</u>
Direct Banking	\$2,147	\$2,104	\$43	2%
Payment Services	69	71	(2)	(3%)
Revenue Net of Interest Expense	<u>\$2,216</u>	<u>\$2,175</u>	<u>\$41</u>	<u>2%</u>

(\$MM)	2Q16	2Q15	Change	
			QOQ	YOY
Discover Card Sales Volume	\$30,702	\$30,017	11%	2%
Rewards Rate ⁽¹⁾	1.21%	1.05%	15 bps	16 bps

- Net interest income of \$1.8Bn, up 7% YOY due primarily to loan growth and higher net interest margin
- Discount and interchange revenue of \$636MM, up 4% YOY driven primarily by an increase in card sales
- Rewards rate increased 16bps YOY driven by higher promotional rewards, primarily double rewards for new accounts
- Protection products revenue of \$59MM, down 13% YOY due to the prior suspension of new product sales
- Other income decreased by \$30MM primarily due to the absence of \$28MM in mortgage origination revenue as the business was exited last year

Note(s)

1. Rewards cost divided by Discover card sales volume

2Q16 Net Interest Margin

(\$MM)	2Q16		2Q15	
	Average Balance	Rate	Average Balance	Rate
Credit Card	\$56,124	12.42%	\$53,987	12.04%
Private Student	8,816	7.13%	8,597	6.91%
Personal	5,608	12.25%	5,131	12.12%
Other	262	5.04%	385	4.62%
Total Loans	70,810	11.72%	68,100	11.35%
Other Interest-Earning Assets	14,562	0.71%	13,905	0.56%
Total Interest-Earning Assets	<u>\$85,372</u>	9.84%	<u>\$82,005</u>	9.52%
Direct to Consumer and Affinity	\$33,215	1.22%	\$29,194	1.23%
Brokered Deposits and Other	14,740	1.78%	16,840	1.55%
Interest Bearing Deposits	47,955	1.39%	46,034	1.35%
Borrowings	24,621	2.82%	23,461	2.67%
Total Interest-Bearing Liabilities	<u>\$72,576</u>	1.88%	<u>\$69,495</u>	1.80%

(%)	2Q16	Change	
		QOQ	YOY
Total Interest Yield	11.72%	3 bps	37 bps
NIM on Receivables	9.94%	-	31 bps
NIM on Interest-Earning Assets	8.25%	-2 bps	25 bps

- Net interest margin on receivables increased 31bps YOY due to higher total yield partially offset by higher funding costs
- Total interest yield of 11.72% increased 37bps YOY driven primarily by higher card yield
- Credit card yield increased 38bps YOY due to portfolio mix and the prime rate increase
- Average direct to consumer and affinity deposits grew 14% YOY and made up 46% of total funding
- Funding costs on interest-bearing liabilities increased 8bps YOY to 1.88% primarily due to higher market rates and funding mix

2Q16 Operating Expense Detail

(\$MM)	2Q16	2Q15	B / (W)	
			\$ Δ	% Δ
Employee Compensation and Benefits	\$340	\$326	(\$14)	(4%)
Marketing and Business Development	198	199	1	1%
Information Processing & Communications	89	90	1	1%
Professional Fees	150	153	3	2%
Premises and Equipment	23	23	-	-
Other Expense	106	136	30	22%
Total Operating Expense	\$906	\$927	\$21	2%
Direct Banking	\$868	\$884	\$16	2%
Payment Services	38	43	5	12%
Total Operating Expense	\$906	\$927	\$21	2%
Operating Efficiency⁽¹⁾	40.9%	42.6%	170 bps	
Adjusted Operating Efficiency⁽²⁾	40.3%	40.7%	40 bps	

- Employee compensation and benefits of \$340MM, up 4% YOY primarily due to higher regulatory and compliance staffing as well as higher salaries
- Professional fees of \$150MM, down 2% YOY. Look back related anti-money laundering remediation expenses were \$12MM in 2Q16 vs. \$19MM in 2Q15
- Other expense of \$106MM, down 22% YOY largely due to the \$23MM in expenses related to exiting the Home Loans business in 2Q15
- In total, prior year mortgage expenses including restructuring charges were \$62MM

Note(s)

1. Defined as reported total operating expense divided by revenue net of interest expense
2. 2Q16 operating efficiency adjusted for \$12 million in look back related anti-money laundering remediation expenses. 2Q15 operating efficiency adjusted for \$23 million associated with the closure of the Home Loans business and \$19 million anti-money laundering and related compliance program enhancement expenses; see appendix for a reconciliation. Management believes adjusted operating efficiency, which is a non-GAAP measure, provides investors with a useful metric to evaluate the ongoing operating performance of the Company

2Q16 Provision for Loan Losses and Credit Quality

(\$MM)	2Q16	2Q15	B / (W)	
			\$ Δ	% Δ
Net Principal Charge-off	\$384	\$347	(\$37)	(11%)
Reserve Changes build/(release)	28	(41)	(69)	NM
Total Provision for Loan Loss	<u>\$412</u>	<u>\$306</u>	<u>(\$106)</u>	<u>(35%)</u>

(%)	2Q16	Change	
		QOQ	YOY
Credit Card Loans			
Gross Principal Charge-off Rate	3.21%	6 bps	7 bps
Net Principal Charge-off Rate	2.39%	5 bps	11 bps
30-Day Delinquency Rate	1.63%	-5 bps	8 bps
Reserve Rate	2.80%	-6 bps	18 bps
Private Student Loans			
Net Principal Charge-off Rate (excl. PCI Loans) ⁽¹⁾	1.10%	25 bps	8 bps
30-Day Delinquency Rate (excl. PCI Loans) ⁽¹⁾	1.88%	-4 bps	10 bps
Reserve Rate (excl. PCI Loans) ⁽¹⁾	1.95%	9 bps	-28 bps
Personal Loans			
Net Principal Charge-off Rate	2.38%	-7 bps	28 bps
30-Day Delinquency Rate	1.02%	5 bps	31 bps
Reserve Rate	3.07%	8 bps	53 bps
Total Loans			
Gross Principal Charge-off Rate (excl. PCI Loans) ⁽¹⁾	2.99%	7 bps	8 bps
Net Principal Charge-off Rate (excl. PCI Loans) ⁽¹⁾	2.27%	6 bps	11 bps
30-Day Delinquency Rate (excl. PCI Loans) ⁽¹⁾	1.60%	-4 bps	11 bps
Reserve Rate (excl. PCI Loans) ⁽¹⁾	2.77%	-3 bps	17 bps

Note(s)

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

- Net charge-offs of \$384MM, up 11% YOY and reserve build of \$28MM both primarily due to loan growth
- Card net charge-off rate increased 11bps YOY to 2.39%
- Card 30+ day delinquency rate of 1.63% increased 8bps YOY
- Student loan net charge-off rate excluding PCI loans of 1.10%, up 8bps YOY
- Personal loan net charge-off rate of 2.38%, up 28bps YOY

Capital Position

Capital Ratios

	Basel III Transition		
	2Q16	1Q16	2Q15
Total Risk Based Capital Ratio	16.7%	16.8%	17.2%
Tier 1 Risk Based Capital Ratio	15.0%	15.0%	15.3%
Tier 1 Leverage Ratio	12.8%	12.8%	13.2%
Common Equity Tier 1 Capital Ratio	14.3%	14.3%	14.5%

	Basel III Fully Phased-in		
Common Equity Tier 1 Capital Ratio ⁽¹⁾	14.2%	14.2%	14.4%

- Common Equity Tier 1 Capital Ratio (Basel III fully phased-in) of 14.2%
- Received non-objection from Federal Reserve for proposed capital actions from 7/1/2016 through 6/30/17
 - Increased quarterly common dividend from \$0.28 to \$0.30 per share on 7/14/16
 - Gross repurchases of up to \$1.95Bn of common stock through four quarters

Note(s)

1. Common Equity Tier 1 Capital Ratio (Basel III Fully Phased-in) is calculated using Basel III Fully Phased-in Common Equity Tier 1 Capital, a non-GAAP measure. The Company believes that the Common Equity Tier 1 Capital Ratio based on Fully Phased-in Basel III rules is an important complement to the existing capital ratios and for comparability to other financial institutions. For the corresponding reconciliation of Common Equity Tier 1 Capital and risk weighted assets calculated under Fully Phased-in Basel III rules to Common Equity Tier 1 Capital and risk weighted assets calculated under Basel III transition rules, see appendix

Appendix

Reconciliation of GAAP to Non-GAAP Data

(unaudited, in millions, except per share statistics)	Quarter Ended	
	Jun 30, 2016	Jun 30, 2015
Provision for loan losses	\$412	\$306
Income before income taxes	898	942
Pre-tax, pre-provision income ⁽¹⁾	<u>\$1,310</u>	<u>\$1,248</u>
Revenue net of interest expense	\$2,216	\$2,175
Total operating expense	906	927
Excluding anti-money laundering and related compliance program expenses	12	19
Excluding expenses related to exiting the Home Loans business	-	23
Adjusted operating expense	<u>\$894</u>	<u>\$885</u>
Adjusted operating efficiency ⁽²⁾	40.3%	40.7%

Note(s)

1. Pre-tax, pre-provision income, which is derived by adding provision for loan losses to pre-tax income, is a non-GAAP financial measure which should be viewed in addition to, and not as a substitute for, the Company's reported results. Management believes this information helps investors understand the effect of provision for loan losses on reported results and provides an alternate presentation of the Company's performance
2. Adjusted operating efficiency is calculated using adjusted operating expense, a non-GAAP measure, divided by revenue net of interest expense. Management believes this information provides investors with a useful metric to evaluate the ongoing operating performance of the Company

Reconciliation of GAAP to Non-GAAP Data (cont'd)

(unaudited, in millions)	Quarter Ended		
	Jun 30, 2016	Mar 31, 2016	Jun 30, 2015
GAAP Total Common Equity	\$10,837	\$10,756	\$10,703
Less: Goodwill	(255)	(255)	(255)
Less: Intangibles	(167)	(167)	(170)
Tangible Common Equity ⁽¹⁾	<u>\$10,415</u>	<u>\$10,334</u>	<u>\$10,278</u>
Common Equity Tier 1 Capital (Basel III Transition)	\$10,677	\$10,593	\$10,552
Adjustments Related to Capital Components During Transition ⁽²⁾	(53)	(54)	(83)
Common Equity Tier 1 Capital (Basel III Fully Phased-in)	<u>\$10,624</u>	<u>\$10,539</u>	<u>\$10,469</u>
Risk Weighted Assets (Basel III Transition)	\$74,892	\$74,205	\$72,658
Risk Weighted Assets (Basel III Fully Phased-in) ⁽³⁾	\$74,824	\$74,137	\$72,555
Common Equity Tier 1 Capital Ratio (Basel III Transition)	14.3%	14.3%	14.5%
Common Equity Tier 1 Capital Ratio (Basel III Fully Phased-in) ⁽⁴⁾	14.2%	14.2%	14.4%

Note(s)

1. Tangible Common Equity ("TCE"), a non-GAAP financial measure, represents common equity less goodwill and intangibles. A reconciliation of TCE to common equity, a GAAP financial measure, is shown above. Other financial services companies may also use TCE and definitions may vary, so users of this information are advised to exercise caution in comparing TCE of different companies. TCE is included because management believes that common equity excluding goodwill and intangibles is a more meaningful measure to investors of the true net asset value of the Company
2. Adjustments related to capital components for fully phased-in Basel III include the phase-in of the intangible asset exclusion
3. Key differences under fully phased-in Basel III rules in the calculation of risk weighted assets include higher risk weighting for past due loans and unfunded commitments
4. Common Equity Tier 1 Capital Ratio (Basel III Fully Phased-in) is calculated using Common Equity Tier 1 Capital (Basel III Fully Phased-in), a non-GAAP measure, divided by Risk Weighted Assets (Basel III Fully Phased-in)