DISCOVER
FINANCIAL SERVICES

Via Electronic Mail: Comments@FDIC.gov

July 1, 2010

Robert Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429
Attention: Comments

Re: Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010
(RIN3064-AD53)

Ladies and Gentlemen:

Discover Financial Services ("Discover") appreciates the opportunity to submit this letter in response to the request for comment by the Federal Deposit Insurance Corporation (the "FDIC") regarding its Notice of Proposed Rulemaking entitled "Treatment by the Federal Deposit Insurance Corporation as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection With a Securitization or Participation After September 30, 2010" (the "NPR").[1] Discover commends the FDIC for its ongoing support of the securitization market and acknowledgment of the vital role that securitizations play in supporting the strength of depository institutions and allowing depository institutions to provide cost-effective credit to consumers. As recognized in the NPR, the legal isolation safe harbor is a critical component of a functioning securitization market, and Discover supports the FDIC's efforts to develop an effective safe harbor in response to recent accounting changes that have impacted issuers' ability to satisfy the requirements of the FDIC's existing rule.

Discover has been active in the credit card securitization market since 1989, securitizing approximately $95 billion in credit card receivables through more than 100 transactions. Credit card securitization has been an important, efficient and cost-effective means for Discover to fund its lending activities, allowing Discover to provide credit to its cardholders at a lower cost than would otherwise have been possible. Securitization also provides Discover with an economical source of contingent funding. Discover issues asset-backed securities both publicly and through

[1] Reference is made in this letter to the FDIC's Advance Notice of Proposed Rulemaking (RIN 3064-AD55) on this subject (the "ANPR"). Discover submitted a response letter to the ANPR on February 22, 2010.

privately placed asset-backed conduit facilities, which may be fully or partially drawn at closing. As of June 30, 2010, Discover had $15.1 billion in securitization funding outstanding as well as $3.5 billion of undrawn capacity under committed conduit facilities. For the past 20 years, Discover's securitization trusts have paid all maturing securities in full and on time and have never had an early amortization event, event of default or other adverse event that would cause early or late repayment. We understand that our ability to continue to fund our receivables through securitization depends on the performance of our assets over time and our ability to repay our investors as they expect. We have been diligent in providing transparency to investors regarding the structure of our securitization trusts and the performance of the underlying assets.

The FDIC has been a long-time supporter of and advocate for securitization, and we believe that the reasons for that support—particularly in the context of credit card securitizations—are still fundamentally sound. The current FDIC Rule adopted in 2000 (12 CFR 360.6 (the "Existing Securitization Rule")) has been a critical component in maintaining the efficient functioning of the securitization market over the past decade. The Existing Securitization Rule established a clear and reliable path to qualifying a transaction under the legal isolation safe harbor, which has provided certainty to issuers and investors as well as the rating agencies. This certainty around legal isolation and regulatory protection allows issuers to attain the highest rating for these securities from the rating agencies by "de-linking" the asset-backed securities from the credit rating of the issuer itself. Achieving a triple-A rating for the senior-most securities in a securitization structure is fundamental to the positive economics of the securitization market that allow issuers to rely on capital markets liquidity, in addition to deposits and other funding channels, to provide cost-effective credit to consumers. Consequently, in order to achieve its stated goal of promoting a robust securitization market going forward, it is incumbent upon the FDIC to structure a new safe harbor with clear and achievable conditions that provides certainty for both issuers and investors and allows issuers to achieve a AAA rating. In our view, such a safe harbor is fully consistent with the overarching responsibility of the FDIC to protect the deposit insurance fund and promote the soundness of the financial system as a whole.

Discover is a member of the American Securitization Forum (the "ASF") and has participated directly in the preparation of the ASF's comment letter on the NPR. While the ASF represents a broad constituency representing the various asset classes that utilize securitizations, many of the comments contained in the ASF response letter touch directly on areas of concern to Discover, and we support the comments and suggestions in the ASF comment letter. In particular, we have referenced below certain issues for which we believe the ASF's reply letter provides valuable discussion. We are also a member of the Financial Services Roundtable (the "FSR") and support the positions set forth in the FSR's comment letter on the NPR.

The following sections present a summary of the issues that Discover believes are most critical with respect to the NPR.

1. Imperative to Ensure New Safe Harbor Rule is Effective

The Existing Securitization Rule has been critical to supporting a robust securitization market primarily because it provides bright-line requirements, which, if met, provide certainty to investors and the rating agencies that the FDIC will not seek to repudiate the trust or reclaim the underlying assets. This certainty allows the ratings of securitization transactions to be "de-linked" from the rating of the sponsoring institution, thereby allowing securitizations to achieve the highest possible rating, which is critical to the functioning, liquidity and economics of the securitization market. Consequently, the new safe harbor rule must provide the same degree of certainty provided by the Existing Securitization Rule in order to ensure a functioning securitization market going forward. The FDIC has acknowledged the importance of a functioning securitization market and has indicated that it is attempting to achieve such a market with the Proposed Rule. However, there are several aspects to the Proposed Rule that raise uncertainty as to whether de-linking of the securitization can be achieved under the Proposed Rule.

a. Consent to Exercise of Remedies Is Not Sufficient Protection Against Repudiation or Reclamation of Assets for Qualifying Securitizations

Unlike the Existing Securitization Rule, which provided a direct safe harbor from a repudiation and/or reclamation of assets by the FDIC, the Proposed Rule merely provides remedies in the event a repudiation or default occurs. This distinction is critical because it raises uncertainty for investors and the rating agencies as to whether the remedies provided in paragraph (d)(4) of the Proposed Rule are adequate to ensure that investors will be made whole in the event of a repudiation or default. In particular, there is uncertainty as to the amount of damages that would be paid to investors and the timing of such payments if the FDIC repudiated a securitization agreement, which could prevent the de-linking of the securitization's rating from the rating of the sponsor. As an example, Standard & Poor's Ratings Services ("S&P") recently indicated that the uncertainty around the damages provisions in the Proposed Rule could make it impossible for S&P to de-link the securitization from the rating of the sponsor.[2] Importantly, this is a concern not just for new issuances, but also for our existing issuances. Because the provisions of the safe harbor under the Existing Securitization Rule are better for investors than the provisions of the Proposed Rule, we may not be able to issue new securities from our existing structures if doing so would subject our current investors to the more limited remedies of the Proposed Rule.

We note that Section III of the ASF's response letter to the NPR provides further discussion of the impact that uncertainty around remedies would have on the potential effectiveness of the safe harbor as set forth in the Proposed Rule, and we share the ASF's concerns on this issue. In particular, we agree with the ASF's proposed solution to the uncertainty raised by the remedies approach taken in paragraph (d)(4) of the Proposed Rule. Paragraph (d)(4) should be revised to track the safe harbor language currently set forth in paragraph (d)(3) but replace the proviso that the transfer satisfies the conditions of sale accounting treatment with a proviso that "the financial assets are subject to a legally enforceable and perfected security interest under applicable law." The bright-line approach would provide certainty to investors and the rating agencies that the trust and its assets qualify for the safe harbor so long as the security interest requirement and other conditions set forth in the Proposed Rule are satisfied.

[2] See http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245214429388

b. Conditions for Qualification Must Be Clear and Achievable at Closing

We continue to be concerned that certain of the conditions to qualify for the safe harbor are either vague or ongoing, and will prevent the achievement of the critical certainty necessary for an effective safe harbor. Again, the Existing Securitization Rule has been effective because it provides a bright-line test for a transaction to qualify for the safe harbor at closing, which provides the required certainty to investors and allows the ratings of securitizations to be de-linked from the ratings of the sponsor. For instance, we provide monthly disclosures of trust performance to all our investors, and have since 1989, but we do not think the safe harbor should be at risk if we fail to do so. Similarly, we provide what we believe to be clear disclosure about our structure and our assets, but we do not believe our investors should lose the protection of the safe harbor if our disclosure is later challenged as being insufficiently clear. By imposing conditions to qualify for the safe harbor that are vague and/or ongoing, the Proposed Rule does not provide enough certainty to ensure that the safe harbor will be effective in giving comfort to investors that there is no risk of repudiation/ reclamation that could force them to bear the risk of losing the safe harbor. Highlighting this concern, Moody's Investors Service, Inc. recently published a report stating that several unclear and subjective preconditions contained in the Proposed Rule "may make the safe harbor elusive." Moody's specifically raised the concern that investors, not sponsors, bear the risk of loss of the safe harbor with respect to conditions that must be satisfied over the life of the transaction.[3] Additionally, we support the comments within Section IV of the ASF's response letter to the NPR, which further discusses the concern that certain conditions to qualification contained in the Proposed Rule could prevent an effective safe harbor.

2. Extension of the Transition Period under Final Rule

Discover commends the FDIC for adopting the Final Rule (the "Transition Period Final Rule") that extended the Existing Securitization Rule's legal isolation safe harbor through September 30, 2010 (the "Transition Period"). However, given the number of significant questions still surrounding the form the new safe harbor rule will take as well as the fundamental structural, documentation, disclosure and other changes that will be required in connection with the new rule, Discover requests that the FDIC extend the Transition Period to 9-12 months after the date on which the final rule is published in the *Federal Register.* The Transition Period may be extended further in order to allow for a coordinated response to both the new safe harbor rule and the other legislative and regulatory reforms that are being proposed with respect to securitizations as discussed in the next section.

For example, the structural, disclosure and other requirements imposed under the Proposed Rule may require issuers to submit new or amended shelf registrations for review and approval by the Securities and Exchange Commission ("SEC"). In addition, the SEC's proposal for changes to the regulations governing asset-backed securities ("New Regulation AB") would fundamentally alter the shelf registration documentation and procedures for securitization facilities, and has not yet been adopted. Until we know the exact parameters of the new requirements that will affect our program, we cannot restructure our program to meet them. As a point of reference, it took us over a year to modify our disclosure and computer systems to accommodate the adoption of the

[3] See http://image.exct.net/lib/fefb127575640d/m/1/05.25.10+Credit+Card_Statement.pdf

current Regulation AB in 2005. Consequently, we expect to need a significant amount of time to prepare and submit new shelf registration documentation that responds to both the Proposed Rule and New Regulation AB, which as stated would be subject to the SEC's review process.

3. Ensure Coordinated Approach with other Reform Proposals

In addition to the fundamental changes arising under the Proposed Rule, sponsors in the securitization markets are also trying to prepare for the requirements expected to be included in the financial regulatory reform legislation expected to be passed shortly by the United States Congress as well as the New Regulation AB proposal. Due to the high degree of overlap between the Proposed Rule and the Congressional legislation and revisions proposed under New Regulation AB, we believe the FDIC should not use the Proposed Rule to impose a set of securitization regulations prior to the passage of the Congressional legislation, effectiveness of New Regulation AB and completion of joint rulemaking required under the new legislation. Discover supports the ASF's position on risks associated with having inconsistencies between the Proposed Rule and the Congressional legislation and/or effectiveness of New Regulation AB and the need for coordination with other reform proposals as set forth in Section II of the ASF response letter.

4. Clarify That Sales to Affiliates Are Permissible Up to a Threshold Amount

Paragraph (c)(1) of the Proposed Rule provides that "the obligations shall not be sold to an affiliate or insider."[4] As drafted, this provision would prevent a trust for which an affiliate holds any interest from obtaining the safe harbor protection under the Proposed Rule, which we do not believe is the FDIC's intent. As discussed in the next paragraph, Discover and many other securitization issuers utilize a structure in which affiliates retain some or all of the credit-enhancing subordinated tranches. We therefore suggest that this portion of paragraph (c)(1) be rewritten to say "no more than 50% of the obligations shall be sold to an affiliate or insider of the sponsor." For the avoidance of doubt, the FDIC should clarify that this maximum percentage does not include any "seller's interest" retained in the trust by the sponsor. Alternatively, the FDIC could re-insert the word "predominately" in paragraph (c)(1) if it deems the bright-line approach inadvisable.

In order to obtain a AAA rating on its most senior securitization issuances, many issuers, including Discover, have periodically issued certain subordinated series or tranches to an affiliate. While the most senior tranche is held exclusively by third parties and represents a clear majority of the outstanding investor interest in Discover's securitization trust, the percentage of outstanding securities owned by affiliates of our sponsor, Discover Bank, has increased in the past 12-18 months due to the ongoing disruption to, or absence of, a public market for these subordinated securities. In addition, we typically hold a significant seller's interest in our

[4] Section (c)(1) of the sample regulatory text that was set forth in the ANPR provided that "the transaction shall not be sold predominately to an affiliate or insider." In our comment letter to the ANPR, Discover requested that the FDIC clarify the meaning of "predominately" in this instance in order to confirm that a structure in which an affiliate purchases credit-enhancing subordinate series in a trust would not be excluded from the benefit of the safe harbor. However, the change the FDIC made in Section (c)(1) in the NPR was simply to strike the word "predominately."

securitization trust to facilitate our ability to enter the market quickly and to cover possible fluctuations in outstanding balances. The size of this seller's interest also increases when outstanding securities mature. We do not believe the existence of the seller's interest, which is a core feature of credit card master trusts, should affect the availability of the safe harbor. We note, further, that in each case these retained interests represent significant "skin in the game" that we maintain with respect to our structures, which align our credit risk management efforts with the interests of investors. This retention of risk is consistent with the Proposed Rule, New Regulation AB and the proposed legislation on regulatory reform, all of which emphasize retention of risk as a fundamental aspect of securitizations.

5. Confirm that Undrawn Commitments are Grandfathered under Transitional Final Rule[5]

Through our securitization trust, Discover often enters into a transaction with an asset-backed commercial paper conduit in which the commitment amount may be fully or partially undrawn at closing. This structure allows Discover to issue additional beneficial interests to the conduit during the term of the commitment, up to a specified maximum amount. Discover and a number of our peers utilize this structure to provide cost-effective contingent liquidity. This structure allows us to utilize this liquidity on as little as one to three days' notice to the conduit sponsor (agent). These undrawn conduit commitments do not represent an unfunded securitization structure, but rather a fully or partially unfunded tranche of a larger issuance trust, with many issuances to third parties outstanding. This securitization structure is viewed favorably by federal banking agencies as a source of liquidity.

As an example, Discover might set up a conduit facility that would allow us to borrow up to $500 million from the conduit at any point during the commitment period. If we decided to draw on the facility, we would send the conduit agent an increase notice that we were drawing, the conduit would arrange to fund us the amount drawn and the outstanding balance of the note would increase. Importantly, the note would be backed by receivables that have already been transferred to the master trust. The interest in the master trust receivables attributable to outstanding securities would increase by the drawn amount, and Discover's "seller's interest" in the master trust receivables would be reduced by the same amount. As consideration for this ongoing commitment, Discover pays an up-front fee and a monthly commitment fee to the conduit.

The clarity we are seeking with respect to the Transitional Period Final Rule relates to the fact that the safe harbor applies to securitizations "for which *beneficial interests* were issued on or before September 30, 2010." In the case of an undrawn conduit, a "beneficial interest" is not technically issued until the draw is made, which in some of our transactions could occur after September 30, 2010. Consequently, we are requesting that the FDIC clarify that the safe harbor set forth in the Transitional Period Final Rule applies to fully or partially undrawn commitments that are entered into prior to September 30, 2010 (or the applicable end date for the transitional safe harbor) that otherwise satisfy the requirements necessary to qualify for the safe harbor provided by the Transitional Period Final Rule. As we have noted above, we are concerned that

[5] For further discussion on the undrawn commitment issue, see the ASF's letter to the FDIC dated April 26, 2010 regarding the Transition Period Final Rule

we may not be able to use the new safe harbor for issuances under our existing structures unless remedies are preserved under the Existing Securitization Rule for our current investors. Therefore, if these undrawn conduits are not grandfathered under the Transitional Period Final Rule, Discover would lose its ability to draw on the facilities and, consequently, the contingent liquidity they provide for Discover's consumer lending business.

We believe our position on this issue is consistent with the FDIC's commentary to the NPR that states "the FDIC does not view the inclusion of existing credit lines that are not fully drawn in a securitization as causing such securitization to be an "unfunded securitization." We believe this clarification was in response to the comment from several industry participants (including Discover and the ASF in separate comment letters) pointing to the use of unfunded conduit facilities or VFNs in the market and asking that they should be included in the safe harbor.

6. Permit Commingling to the Extent Negotiated by the Parties

Paragraph (c)(7) of the Proposed Rule provides that "to the extent the sponsor serves as servicer, custodian or paying agent provider for the securitization, the sponsor shall not comingle amounts received with respect to the financial assets with its own assets except for the time necessary to clear any payments received and in no event greater than a two-day period." This proposal provides a useful example of an area where the FDIC needs to distinguish between the various asset-classes that utilize securitization when crafting the final rule. Prohibiting commingling in an amortizing structure (e.g., mortgages and auto loans) may provide a valuable protection for investors. However, prohibiting commingling in a revolving structure (e.g., credit cards) would significantly impact the economics of the issuer without providing a corresponding benefit to the investors.

Many sponsors with revolving trusts, including Discover, utilize a structure that permits commingling for a brief period so long as certain conditions are met – e.g., for so long as the servicer maintains a required short-term rating. Discover is currently required only to trap collections on trust assets in segregated trust accounts that are necessary to satisfy all scheduled payments of principal and interest on our outstanding securities and certain other amounts allocable to investors, while the remaining collections may be commingled with the other assets of Discover Bank. Investors are further protected since the underlying assets in a revolving structure, by definition, do not run off as they do in an amortizing structure like a mortgage or auto loan. The availability of these remaining collections provides Discover (and other sponsors who utilize this structure) with a critical source of liquidity that can be used, among other things, to fund additional consumer lending. Consequently, we believe commingling should be permitted, at least in a revolving trust structure, to the extent it has been agreed upon by the parties to the transaction and is reflected in the program's governing documents.

Separately, the Proposed Rule prohibits commingling for more than "two days" rather than "two business days." In addition to allowing contractually permitted commingling, we request that the FDIC revise the permissible commingling period to two *business* days.

7. **Responses to questions raised by the NPR**

Question 3: Is the transition period to September 30, 2010, sufficient to implement the changes required by the conditions identified by Pargraph (b) and (c)? In light of New Regulation AB, how does this transition period impact existing shelf registration?

See Section 2 above for Discover's response to Question 3.

Question 14: Do you have any other comments on the conditions imposed by paragraphs (b) and (c)?

Paragraph (c)(6) of the Proposed Rule provides that "the transfer and duties of the sponsor as transferor must be evidenced in a separate agreement from its duties, if any, as servicer, custodian, paying agent, credit support provider or in any other capacity other than transferor." Discover's securitization facility utilizes a Pooling and Servicing Agreement ("PSA") that establishes our master trust and clearly defines and governs Discover Bank's obligations as both transferor and servicer for the facility. The PSA has been one of the key governing documents for our securitization program since October 1993, and we believe that many other issuers in the credit card securitization market utilize this same approach. The PSA is described in the disclosure documentation for Discover's securitization facility and is freely available to investors. Discover does not believe that requiring these duties to be evidenced by separate agreements would provide any additional transparency or protection for investors. Further, satisfying this requirement would require significant time, effort and expense along with the possible additional burden of attaining required certificate and noteholder approval for the necessary amendments to the program documents. We are requesting that our program documents be grandfathered so that we can continue to issue under our existing securitization program without having to undertake this amendment process.

Question 15: Is the scope of the safe harbor provisions in paragraph (d) adequate? If not, what changes would you suggest?

See Section 1 above for Discover's response to Question 15.

Question 16: Do the provisions of paragraph (d)(4) adequately address concerns about the receiver's monetary default under the securitization document or repudiation of the transaction?

See Section 1 above for Discover's response to Question 16.

Question 17: Could transactions be structured on a de-linked basis given the clarification provided in paragraph (d)(4)?

See Section 1 above for Discover's response to Question 17. As stated in Section 1, in order to achieve de-linking between the rating of a securitization and the rating of the sponsor, the FDIC must provide a rule that establishes a clear and achievable set of conditions to qualify for the safe harbor that, if satisfied, will result in a clear commitment from the FDIC not to repudiate the transaction or reclaim the underlying assets.

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Discover very much appreciates your consideration of our responses and comments to the questions posed by the NPR and the views of other industry participants. Should you have any questions concerning our views and recommendations, please do not hesitate to contact me at 224.405.1380.

Sincerely,

Steven Cunningham
Senior Vice President and Treasurer