Discover Bank

Consolidated Financial Statements for the Years Ended November 30, 2005 and 2004

DISCOVER BANK

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MANAGEMENT'S REPORT ON CONSOLIDATED FINANCIAL STATEMENTS, INTERNAL CONTROL AND COMPLIANCE WITH LAWS AND REGULATIONS

To the Shareholder:

The management of Discover Bank (the "Bank") is responsible for the preparation, integrity, and fair presentation of its published consolidated financial statements and all other information presented in this annual report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and, as such, include amounts based on informed judgments and estimates made by management.

Management is responsible for establishing and maintaining effective internal control over financial reporting, including safeguarding of assets, for financial presentations in conformity with both generally accepted accounting principles and the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income ("Call Report instructions"). The internal control contains monitoring mechanisms, and actions are taken to correct deficiencies identified.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to consolidated financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

Management assessed the Bank's internal control over financial reporting, including safeguarding of assets, for financial presentations in conformity with both generally accepted accounting principles and Call Report instructions as of November 30, 2005. This assessment was based on criteria for effective internal control over financial reporting, including safeguarding of assets, described in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management believes that the Bank maintained effective internal control over financial reporting, including safeguarding of assets, for financial presentations in conformity with both generally accepted accounting principles and Call Report instructions as of November 30, 2005.

The Audit Committee of the Board of Directors is composed entirely of outside directors who are independent of the Bank's management; it includes members with banking or related management experience, has access to its own outside counsel, and does not include any large customers of the institution. The Audit Committee is responsible for recommending to the Board of Directors the selection of independent auditors. It meets periodically with management, the independent auditors, and the internal auditors to ensure that they are carrying out their responsibilities. The Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting and auditing procedures of the Bank in addition to reviewing the Bank's consolidated financial reports. The independent auditors and the internal auditors have full and free access to the Audit Committee, with or without the presence of management, to discuss the adequacy of the internal control over financial reporting and any other matters which, they believe, should be brought to the attention of the Committee.

Management is also responsible for implementing programs and procedures designed to assure compliance with the federal laws and regulations concerning loans to insiders and the federal and state laws and regulations concerning dividend restrictions, both of which are designated by the Federal Deposit Insurance Corporation ("FDIC") as safety and soundness laws and regulations.

Management assessed its compliance with the designated safety and soundness laws and regulations and has maintained records of its determinations and assessments as required by the FDIC. Based on this assessment, management believes that the Bank has complied, in all material respects, with the designated safety and soundness laws and regulations for the year ended November 30, 2005.

David W. Nelms	Michael F. Rickert
Chairman	Vice-President
Chief Executive Officer	Chief Accounting Officer and Treasurer

February 13, 2006

Deloitte.

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INDEPENDENT ACCOUNTANTS' REPORT

To the Audit Committee of
Discover Bank

We have examined management's assertion, included in the accompanying "Management's Report on Consolidated Financial Statements, Internal Control and Compliance with Laws and Regulations," that Discover Bank (the "Bank") maintained effective internal control over financial reporting, including safeguarding of assets, presented in conformity with both accounting principles generally accepted in the United States of America and the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income ("Call Report Instructions") as of November 30, 2005, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO report"). Management is responsible for maintaining effective internal control over financial reporting, including safeguarding of assets. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that the Bank maintained effective internal control over financial reporting, including safeguarding of assets, presented in conformity with both accounting principles generally accepted in the United States of America and the Call Report Instructions as of November 30, 2005, is fairly stated, in all material respects, based on the criteria established in the COSO report.

We have not examined and, accordingly, we do not express an opinion or any other form of assurance on management's statement referring to compliance with laws and regulations.

Deloitte & Touche LLP

February 13, 2006

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholder of
Discover Bank

We have audited the accompanying consolidated financial statements of Discover Bank (the "Bank") as of and for the years ended November 30, 2005 and 2004 listed in the foregoing Table of Contents. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Bank as of November 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

February 13, 2006

DISCOVER BANK

CONSOLIDATED STATEMENTS OF CONDITION
NOVEMBER 30, 2005 AND 2004
(In thousands, except share data)

ASSETS	2005	2004
CASH AND CASH EQUIVALENTS	$ 288,075	$ 255,367
FEDERAL FUNDS SOLD	250,000	500,000
INVESTMENT SECURITIES	14,727	12,022
CONSUMER LOANS:		
Credit cards	17,981,320	17,078,411
Loans held for sale	2,437,060	1,505,574
Mortgage and installment	173,479	282,336
Total consumer loans	20,591,859	18,866,321
Less allowance for loan losses	(795,057)	(910,261)
Net consumer loans	19,796,802	17,956,060
ACCRUED INTEREST AND OTHER RECEIVABLES	131,545	114,750
AMOUNTS DUE FROM ASSET SECURITIZATIONS	1,084,262	884,190
DEFERRED INCOME TAXES	111,965	59,123
OTHER ASSETS	121,074	111,413
TOTAL ASSETS	$21,798,450	$19,892,925

LIABILITIES AND SHAREHOLDER'S EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$ 76,738	$ 58,246
Interest-bearing	15,970,574	12,876,227
Total deposits	16,047,312	12,934,473
Accounts payable, accrued expenses and other liabilities	1,021,340	964,543
Due to parent and affiliates, net	205,061	189,829
Notes payable and other borrowings	1,315,298	2,985,277
Total liabilities	18,589,011	17,074,122
SHAREHOLDER'S EQUITY:		
Common stock ($25 par value; 1,400 shares authorized, issued and outstanding)	35	35
Additional paid-in capital	778,632	778,632
Retained earnings	2,430,544	2,039,754
Accumulated other comprehensive income	228	382
Total shareholder's equity	3,209,439	2,818,803
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$21,798,450	$19,892,925

See notes to consolidated financial statements.

DISCOVER BANK

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED NOVEMBER 30, 2005 AND 2004
(In thousands)

	2005	2004
INTEREST REVENUE:		
Consumer loans	$ 1,911,038	$ 1,672,393
Amounts due from asset securitizations	28,497	1,823
Investment securities and federal funds sold	18,422	4,626
Total interest revenue	1,957,957	1,678,842
INTEREST EXPENSE:		
Deposits	611,368	515,085
Notes payable and other borrowings	41,999	26,950
Overnight federal funds purchased	183	398
Total interest expense	653,550	542,433
NET INTEREST INCOME	1,304,407	1,136,409
PROVISION FOR LOAN LOSSES	815,456	893,457
NET CREDIT INCOME	488,951	242,952
NONINTEREST REVENUES:		
Servicing and securitization income	1,546,647	1,849,981
Net interchange, cardmember and other	1,034,456	1,134,054
Total noninterest revenues	2,581,103	2,984,035
NONINTEREST EXPENSES:		
Employee compensation and benefits	55,553	52,440
Information processing and other	2,120,581	1,977,852
Total noninterest expenses	2,176,134	2,030,292
INCOME BEFORE LOSSES FROM UNCONSOLIDATED INVESTEES AND INCOME TAXES	893,920	1,196,695
LOSSES FROM UNCONSOLIDATED INVESTEES	2,089	1,691
INCOME TAXES	326,041	435,030
NET INCOME	$ 565,790	$ 759,974

See notes to consolidated financial statements.

DISCOVER BANK

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED NOVEMBER 30, 2005 AND 2004
(In thousands)

	2005	2004
NET INCOME	$ 565,790	$ 759,974
OTHER COMPREHENSIVE INCOME, NET OF TAX:		
Unrealized (loss)/gain on investment securities available-for-sale	(154)	293
COMPREHENSIVE INCOME	$ 565,636	$ 760,267

See notes to consolidated financial statements.

DISCOVER BANK

CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY
YEARS ENDED NOVEMBER 30, 2005 AND 2004
(In thousands)

	2005	2004
COMMON STOCK	$ 35	$ 35
ADDITIONAL PAID-IN CAPITAL	778,632	778,632
RETAINED EARNINGS:		
Balance, beginning of year	2,039,754	1,916,780
Net income	565,790	759,974
Dividends paid	(175,000)	(637,000)
Balance, end of year	2,430,544	2,039,754
ACCUMULATED OTHER COMPREHENSIVE INCOME, NET OF TAX:		
Balance, beginning of year	382	89
Other comprehensive income	(154)	293
Balance, end of year	228	382
TOTAL SHAREHOLDER'S EQUITY	$ 3,209,439	$ 2,818,803

See notes to consolidated financial statements.

DISCOVER BANK

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED NOVEMBER 30, 2005 AND 2004
(In thousands)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 565,790	$ 759,974
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	815,456	893,457
Accrual for fraud losses	15,220	-
Amortization of deferred revenue	(37,394)	(37,971)
Other amortization and depreciation	92,608	74,572
Deferred income taxes	(52,755)	(14,240)
Loss on credit card asset securitizations, net	63,570	8,858
Gain on sale of consumer loans	(6,195)	(9,673)
Loss (gain) on investment securities, net	3	(150)
Deferred premium on purchase of consumer loans	172	105
Change in operating assets and liabilities:		
Accrued interest and other receivables	(16,795)	63,700
Amounts due from asset securitizations	(263,642)	66,780
Other assets	(63,744)	(36,950)
Accounts payable, accrued expenses and other liabilities	94,192	105,792
Due to parent and affiliates, net	15,232	(371,927)
Net cash provided by operating activities	1,221,718	1,502,327
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net proceeds from (payments for):		
Federal funds sold	250,000	(100,000)
Investment securities, net	(2,949)	2
Net principal disbursed on credit card loans	(10,054,927)	(5,224,841)
Securitization of credit card loans, net	7,242,108	3,257,718
Purchase of mortgage loans, net	(24,448)	(44,019)
Sales of mortgage loans	217,592	248,863
Mortgage and installment loans, net	(84,245)	(89,069)
Net cash used in investing activities	(2,456,869)	(1,951,346)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from (payments for):		
Noninterest-bearing deposits	18,491	(2,593)
Certificates of deposit	2,941,837	769,518
Other interest-bearing deposits	152,510	(116,076)
Federal funds purchased	-	(472,400)
Notes payable and other borrowings	(1,669,979)	357,326
Dividends paid	(175,000)	(637,000)
Net cash provided by (used in) financing activities	1,267,859	(101,225)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	32,708	(550,244)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	255,367	805,611
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 288,075	$ 255,367
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the year for:		
Interest	$ 588,823	$ 550,854
Income taxes, net of income tax refunds	$ 403,370	$ 461,166
SUPPLEMENTAL SCHEDULE OF NONCASH ACTIVITIES:		
Interest due from income tax settlement	$ (12,455)	$ (16,747)
Unrealized loss (gain) on investment securities available for sale	$ 241	$ (461)

See notes to consolidated financial statements.

1. INTRODUCTION AND BASIS OF PRESENTATION

Discover Bank (the "Bank"), a Delaware state-chartered bank, is a wholly-owned subsidiary of NOVUS Credit Services Inc. ("NCSI") and an indirect subsidiary of Morgan Stanley. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation ("FDIC") for up to $100,000 per depositor.

The consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America, which require management to make estimates and assumptions regarding consumer loan loss levels, the potential outcome of litigation, and other matters that affect the consolidated financial statements and related disclosures. Actual results could differ materially from these estimates.

Certain reclassifications have been made to prior year amounts to conform to the current presentation. Included in these reclassifications to the fiscal 2004 consolidated statement of condition are $507,000 from Other assets to Investment securities and $1,404,000 from Other assets to Mortgage and installment – Consumer loans. These reclassifications were made to align more closely to balance sheet classifications of the parent company.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents - For purposes of these consolidated statements, cash and cash equivalents consist of cash and highly liquid investments (other than federal funds sold) with maturities, when purchased, of three months or less.

Consumer Loans - Consumer loans, which consist primarily of general purpose credit card, mortgage and consumer installment loans, are reported at their principal amounts outstanding less applicable allowances. Interest and fees on consumer loans, which includes charges to cardmembers for late payment fees, overlimit fees, balance transfer fees, credit protection fees and cash advance fees, are credited to income as earned.

Loans held for sale represent primarily credit card loans that the Bank intends to securitize within three months, net of amortizing securitizations. These loans are carried at the lower of aggregate cost or fair value.

Interest and fees are generally accrued on credit card loans until the date of charge-off, which generally occurs at the end of the month during which an account becomes 180 days past due, except in the case of cardmember bankruptcies, deceased cardmembers and fraudulent transactions. Cardmember bankruptcies and deceased cardmember accounts are charged-off at the end of the month 60 days following the receipt of notification of the bankruptcy or death but not later than the 180-day contractual time frame. The Bank records charged-off cardmember fees and interest revenue directly against the income statement line items to which they were originally recorded. Origination costs related to the issuance of credit cards are deferred and charged to earnings over periods not exceeding 12 months.

The practice of re-aging an account also may affect general purpose credit card loan delinquencies and charge-offs. A re-age is intended to assist delinquent cardmembers who have experienced financial difficulties. An account is re-aged when the Bank and the customer agree on a temporary repayment schedule that may include concessionary terms. The re-age account and related balance is then returned to current status. Cardmembers may also qualify for a work-out re-age when either a longer term or permanent hardship exists.

Beginning in the third quarter of fiscal 2005, the Bank began recognizing anticipated fraud losses at their net estimated realizable value by recording a charge to Information processing and other - Noninterest expenses upon notification of the fraudulent transactions. The actual fraud losses are subsequently written off at the end of the month 90 days following notification, but no later than the 180-day contractual time frame.

Allowance for Loan Losses – The allowance for consumer loan losses is a significant estimate that represents management's estimate of probable losses inherent in the consumer loan portfolio. The allowance for consumer loan losses is primarily applicable to the owned homogeneous consumer credit card loan portfolio that is evaluated quarterly for adequacy and is established through a charge to the provision for consumer loan losses.

In calculating the allowance for consumer loan losses, the Bank uses a systematic and consistently applied approach. The Bank regularly performs a migration analysis (a technique used to estimate the likelihood that a consumer loan will progress through the various stages of delinquency and ultimately charge-off) of delinquent and current consumer credit card accounts in order to determine the appropriate level of the allowance for consumer loan losses. The migration analysis considers uncollectible principal, interest and fees reflected in consumer loans. In evaluating the adequacy of the allowance for consumer loan losses, management also considers factors that may impact future credit loss experience, including current economic conditions, recent trends in delinquencies and bankruptcy filings, account collection management, policy changes, account seasoning, loan volume and amounts, payment rates and forecasting uncertainties. A provision for consumer loan losses is charged against earnings to maintain the allowance for consumer loan losses at an appropriate level.

Credit Card Securitization Activities - The Bank periodically sells credit card loans through asset securitizations and continues to service these loans. The Bank may retain interests in the securitized financial assets as an undivided seller's interest, accrued interest and fees ("accrued interest receivable") on securitized credit card receivables, cash collateral accounts, servicing rights, rights to any excess cash flows remaining after payments to investors in the securitization trust of their contractual rate of return and reimbursement of credit card losses, and other retained interests. The exposure to credit losses from securitized loans is limited to the Bank's retained contingent risk, which represents the Bank's retained interest in securitized loans, including any credit enhancement provided. The gain or loss on the sale of the financial assets depends in part on the previous carrying amount of the assets involved in the transfer, and each subsequent transfer in revolving structures, allocated between the assets sold and the retained interests based upon their respective fair values at the date of sale. To obtain fair values, quoted market prices are used if available. However, observable market prices are generally not available for retained interests, so the Bank estimates fair value based on the present value of expected future cash flows using management's best estimate of the key assumptions, including forecasted credit losses, payment rates, forward yield curves and discount rates commensurate with the risks involved. The present value of future net servicing revenues that the Bank estimates it will receive over the term of the securitized loans is recognized in income as the loans are securitized. A corresponding asset also is recorded and then amortized as a charge to income over the term of the securitized loans, with actual net servicing revenues continuing to be recognized in income as they are earned.

As part of the Bank's securitization activities, the Bank provides representations and warranties that certain securitized assets conform to specified guidelines. The Bank may be required to repurchase such assets or indemnify the purchaser against losses if the assets do not meet certain conforming guidelines. In accordance with FASB Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", the Bank is required to disclose information about these obligations. Due diligence is performed by the Bank to ensure that asset guideline qualifications are met. The maximum potential amount of future payments the Bank could be required to make would be equal to the current outstanding balances of all assets subject to such securitization activities. The Bank has not recorded any contingent liability in the consolidated financial statements for these representations and warranties and believes that the probability of any payments under these arrangements is remote.

Investment Securities- Investment securities include both those available-for-sale and held-to-maturity. Investment securities consist of primarily mortgage-backed securities issued by government and government sponsored agencies and state agency bonds, which generally have maturities, when purchased, of six months or more.

Income Taxes - Income tax expense is provided for using the asset and liability method, under which deferred tax assets and liabilities are determined based upon the temporary differences between the consolidated financial statement and income tax bases of assets and liabilities using currently enacted tax rates. The Bank is included in the consolidated federal income tax return of Morgan Stanley. Federal income tax expense (benefit) has been calculated on a separate return basis, with payments made to or received from Morgan Stanley in accordance with intercompany tax allocation arrangements.

Interchange – Interchange is a fee the Bank receives from Discover Financial Services LLC ("DFSL"), an affiliate, for cardmember transactions processed through its proprietary merchant network, Discover Network. Interchange provides the Bank, as issuer of the credit card accounts, compensation for risk assumed, grace period carrying costs and other operating costs. The Bank records interchange in Net interchange, cardmember and other – Noninterest revenues.

Cardmember Rewards – Cardmember rewards include various reward programs, including the Cashback Bonus® reward program, pursuant to which the Bank pays certain cardmembers a percentage of their purchase amounts based upon a cardmember's level and type of purchases. The liability for cardmember rewards, included in Accounts payable, accrued expenses and other liabilities, is accrued at the time that qualified cardmember transactions occur and is calculated on an individual cardmember basis. In determining the liability for cardmember rewards, the Bank considers estimated forfeitures based on historical account closure, charge-off and transaction activity. In accordance with Emerging Issues Task Force ("EITF") Issue No. 00-22, "Accounting for 'Points' and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future," the Bank records its Cashback Bonus reward program as a reduction of Net interchange, cardmember and other – Noninterest revenues.

Investments in Unconsolidated Investees – The Bank invests in low income housing partnerships related to its Community Reinvestment Act program. The Bank accounts for these investments under the equity method. The Bank's share of operating losses generated by these investments is recorded within Losses from unconsolidated investees, and the tax credits and benefits associated with these losses are recorded within the Bank's provision for income tax.

Financial Instruments Used for Asset and Liability Management – The Bank enters into derivative financial instruments, interest rate swaps, for non-trading purposes. The Bank uses interest rate swaps to manage interest rate risk arising from certain borrowings. Derivative financial instruments are designated and qualify as fair value hedges in accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. For qualifying fair value hedges, the changes in the fair value of the derivative and the gain or loss on the hedged asset or liability relating to the risk being hedged are recorded currently in earnings. These amounts are recorded in Interest expense and provide offset of one another. Ineffectiveness relating to fair value hedges, if any, is recorded in Interest expense. Changes in the fair value of interest rate swaps that have been de-designated from the hedged liability, if any, are currently recorded in Net interchange, cardmember and other – Noninterest revenues and were not material to the consolidated statements of income for the periods presented.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140." SFAS No. 155 will be effective for all financial instruments acquired, issued or subject to a remeasurement event occurring after the beginning of an entity's first fiscal year that begins after September 15, 2006. SFAS No. 155 primarily resolves certain issues addressed in the implementation of SFAS No. 133 concerning beneficial interest in securitized financial assets. The adoption of SFAS No. 155 is not expected to have a material effect on the Bank's financial position or net income.

Regulatory Matters – On January 8, 2003, the Federal Financial Institutions Examination Council ("FFIEC") issued guidance on "Account Management and Loss Allowance Practices" for credit card lending. The guidance addresses credit line management, overlimit practices, workout and forbearance practices and income recognition and loss allowance practices. The Bank has implemented changes to and continues to review its existing policies, practices and systems to ensure compliance with the guidance.

In response to industry-wide regulatory guidance, the Bank has increased minimum payment requirements on certain general purpose credit card loans and will implement further minimum payment increases beginning in the second quarter of fiscal 2006. This increase in minimum payment requirements is expected to negatively impact future levels of general purpose credit cards loans and related interest and fee revenue and charge-offs.

3. FEDERAL FUNDS SOLD

Federal funds sold are recorded at cost and amounted to $250,000,000 and $500,000,000 on November 30, 2005 and 2004, respectively, and had weighted average annual interest rates of 4.03 percent and 2.07 percent, respectively, with remaining maturities of less than one month.

4. CONSUMER LOANS

The Bank's consumer loans, which consist primarily of credit card loans, had net balances of $19.8 billion and $18.0 billion at November 30, 2005 and 2004, respectively.

The following presents loans held for sale at November 30, 2005 and 2004:

	2005	2004
Credit cards	$ 2,434,210	$ 1,500,000
Mortgage and installment	2,850	5,574
Total	$ 2,437,060	$ 1,505,574

Activity in the allowance for loan losses for the years ended November 30, 2005 and 2004 was as follows:

	2005	2004
	(In thousands)	
Balance, beginning of year	$ 910,261	$ 963,093
Additions:		
Provision for loan losses	815,257	893,457
Deductions:		
Charge-offs	1,075,977	1,060,990
Less recoveries	(145,516)	(114,701)
Net charge-offs	930,461	946,289
Balance, end of year	$ 795,057	$ 910,261

Information on net charge-offs of interest and cardmember fees was as follows:

	2005	2004
	(In millions)	
Interest accrued on general purpose credit card loans subsequently charged off, net of recoveries (recorded as a reduction of Consumer loans - Interest revenue)	$ 219	$ 229
Cardmember fees accrued on general purpose credit card loans subsequently charged off, net of recoveries (recorded as a reduction to Net interchange, cardmember and other - Noninterest revenues)	$ 117	$ 141

At November 30, 2005, the Bank had commitments to extend credit on credit cards in the amount of $242 billion. Such commitments arise primarily from agreements with customers for unused lines of credit on certain credit cards provided there is no violation of conditions established in the related agreements. These commitments, substantially all of which the Bank can terminate at any time and which do not necessarily represent future cash requirements, are periodically reviewed based on account usage and the cardmember's creditworthiness.

During fiscal 2005, the Bank sold $92,761,000 in mortgage loans to an unaffiliated third party at a net gain of $81,000, which included a $199,000 reversal of allowance for loan losses. The gain on this transaction is included in Net interchange, cardmember and other-Noninterest revenues. In addition, the bank periodically sells consumer loan products to Morgan Stanley Credit Corporation ("MSCC"), an affiliate of the Bank. These transactions are discussed in Footnote 7.

The Bank's credit card portfolio, including securitized loans, is geographically diverse, with a distribution approximating that of the population of the United States.

Credit Card Securitization Activities - The Bank's retained interests in credit card asset securitizations include an undivided seller's interest, accrued interest receivable on securitized credit card receivables, servicing rights, rights to any excess cash flows ("Residual Interests") remaining after payments to investors in the securitization trust of their contractual rate of return and reimbursement of credit losses, and other retained interests. The undivided seller's interest less an applicable allowance for loan losses is carried at cost in Consumer loans. The Bank's undivided seller's interest ranks *pari passu* with investors' interests in the securitization trust, and the remaining retained interests are subordinate to investors' interests. Accrued interest receivable and certain other subordinated retained interests are recorded in Amounts due from asset securitizations at amounts that approximate fair value. The Bank receives annual servicing fees of 2% of the investor principal balance outstanding. The Bank does not recognize a servicing asset or a servicing liability for servicing rights since the servicing contract provides just adequate compensation (as defined in SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities") to the Bank for performing the servicing. Residual Interests are recorded in Amounts due from asset securitization and reflected at fair value with changes in fair value recorded currently in earnings. At November 30, 2005, the Bank had $10.3 billion of retained interests, including $9.3 billion of undivided seller's interest, in credit card asset securitizations. The retained interests are subject to credit, payment and interest rate risks on the transferred credit card assets. The investors and the securitization trust have no recourse to the Bank's other assets for failure of cardmembers to pay when due.

During fiscal 2005 and fiscal 2004, the Bank completed credit card asset securitizations of $7.2 billion and $3.3 billion, respectively. The uncollected balances of securitized general-purpose credit card loans were $23.8 billion and $27.1 billion at November 30, 2005 and November 30, 2004, respectively. The Bank recognized net securitization losses of $63.6 million and $8.9 million, respectively, as Servicing and securitization income in the Bank's consolidated statements of income.

Key economic assumptions used in measuring the Residual Interests at the date of securitization resulting from credit card asset securitizations completed during fiscal 2005 and fiscal 2004 were as follows:

	Fiscal 2005	**Fiscal 2004**
Weighted average life (in months)	4.1 - 5.9	5.9 - 6.1
Payment rate (rate per month)	18.52% - 21.14%	18.00% - 18.35%
Credit losses (rate per annum)	5.60% - 6.00%	6.45% - 6.90%
Discount rate (rate per annum)	11.00% - 12.00%	12.00% - 14.00%

Key economic assumptions and the sensitivity of the current fair value of the Residual Interests to immediate 10 percent and 20 percent adverse changes in those assumptions were as follows:

	At November 30, 2005		**At November 30, 2004**	
	($ In millions)			
Residual interests (carrying amount/fair value)	$	180	$	245
Weighted average life (in months)		4.3		5.2
Payment rate (rate per month)		21.14%		18.52%
Impact on fair value of 10% adverse change	$	(19)	$	(16)
Impact on fair value of 20% adverse change	$	(35)	$	(30)
Credit losses (rate per annum)		6.00%		6.00%
Impact on fair value of 10% adverse change	$	(38)	$	(58)
Impact on fair value of 20% adverse change	$	(76)	$	(116)
Discount rate (rate per annum)		11.00%		12.00%
Impact on fair value of 10% adverse change	$	(1)	$	(2)
Impact on fair value of 20% adverse change	$	(2)	$	(4)

The sensitivity analysis in the table above is hypothetical and should be used with caution. Changes in fair value based on a 10 percent or 20 percent variation in an assumption generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the Residual Interests is calculated independent of changes in any other assumption; 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 credit losses), which might magnify or counteract the sensitivities. In addition, the sensitivity analysis does not consider any corrective action that management may take to mitigate the impact of any adverse changes in the key assumptions.

The table below summarizes certain cash flows received from the securitization master trust:

	Fiscal 2005	Fiscal 2004
	(In billions)	
Proceeds from new credit card asset securitizations	$ 7.2	$ 3.3
Proceeds from collections reinvested in previous credit card asset securitizations	$ 52.2	$ 59.3
Contractual servicing fees received	$ 0.5	$ 0.6
Cash flows received on retained interests	$ 1.4	$ 1.4

The table below presents quantitative information about delinquencies, net principal credit losses and components of managed general purpose credit card loans, including securitized loans:

	At November 30, 2005		Fiscal 2005	
	(In millions)			
	Loans Outstanding	Loans Delinquent (1)	Average Loans	Net Principa Credit Losse
Managed general purpose credit card loans	$ 44,242	$ 1,760	$ 44,716	$ 2,369
Less: Securitized general purpose credit card loans	23,826			
Owned general purpose credit card loans	$ 20,416			

	At November 30, 2004		Fiscal 2004	
	(In millions)			
	Loans Outstanding	Loans Delinquent (1)	Average Loans	Net Principa Credit Losse
Managed general purpose credit card loans	$ 45,663	$ 2,123	$ 44,997	$ 2,753
Less: Securitized general purpose credit card loans	27,085			
Owned general purpose credit card loans	$ 18,578			

(1) Includes loans 30 or more days delinquent.

5. DEPOSITS

A summary of interest-bearing deposits at November 30, 2005 and 2004 is as follows:

	2005	2004
	(In thousands)	
Certificates of deposit in amounts less than $100,000	$ 1,138,199	$ 1,020,965
Certificates of deposit in amounts of $100,000 or greater (1)	14,036,824	11,212,221
Savings deposits, including money market deposit accounts	795,551	643,041
Total	$ 15,970,574	$ 12,876,227
Average annual interest rate (2)	4.21 %	4.50 %

(1) These were primarily participated out by brokers in shares of $100,000 or less. Both periods include the fair value adjustments resulting from interest rate agreements.

(2) Average annual interest rates exclude the effects of interest rate agreements.

At November 30, 2005, certificates of deposit maturing over the next five fiscal years were as follows:

Year	(In thousands)
2006	$ 7,793,757
2007	3,696,988
2008	1,372,644
2009	635,442
2010	698,700

6. NOTES PAYABLE AND OTHER BORROWINGS

The Bank's Notes payable and other borrowings at November 30, 2005 and 2004 are summarized as follows:

	2005		2004	
	Amount Outstanding (In thousands)	Average Annual Interest Rate	Amount Outstanding (In thousands)	Average Annual Interest Rate
Short-term:				
Overnight federal funds purchased	$ -	2.52 %	$ -	1.45 %
Term federal funds purchased	-	2.54	1,592,000	1.41
Notes payable to parent - NCSI	1,022,801	3.19	1,100,900	1.43
Long-term (1):				
Notes payable to parent - NCSI	42,880	7.10	42,880	7.03
Global Bank Notes	249,617	3.42	249,497	1.68
Total	$ 1,315,298	3.10 %	$ 2,985,277	1.60 %

(1) Includes maturities greater than one year.

The debt agreements on notes payable to parent provide for repayment at any time, subject to certain limitations, with original maturities ranging from on demand to twenty years. Interest rates on these notes are based on a market rate of interest, including any associated borrowing costs. Interest expense on notes payable to parent was $20,109,000 and $6,573,000 for the years ended November 30, 2005 and 2004, respectively.

At November 30, 2005, Notes payable and other borrowings had maturities in the following fiscal years:

	(In thousands)
2006 (1)	$ 1,025,981
2007 - 2010	249,617
2011 and thereafter	39,700
Total	$ 1,315,298

(1) The debt agreements on notes payable to parent provide for repayment at any time subject to certain limitations.

7. TRANSACTIONS WITH PARENT AND AFFILIATES

At November 30, 2005 and 2004, the amounts due to parent and affiliates, net, are as follows:

	2005	2004
	(In thousands)	
Due to:		
DFSL (1)	$ 207,888	$ 189,653
Parent and other affiliates	773	1,684
Total	208,661	191,337
Less amounts due from parent and affiliates	(3,600)	(1,508)
Due to parent and affiliates, net	$ 205,061	$ 189,829

(1) DFSL, formerly Discover Financial Services, Inc., is a wholly-owned subsidiary of NCSI.

At November 30, 2005 and 2004, amounts included in deposits related to parent and affiliates are as follows:

	2005	2004
	(In thousands)	
Noninterest-bearing deposits:		
DFSL	$ 5,163	$ 5,368
Interest-bearing deposits:		
NCSI	$ 4,025	$ 4,015
Other affiliates	224	216
Total interest-bearing deposits	$ 4,249	$ 4,231

The average balance in interest-bearing deposit accounts related to parent and affiliates was $4,237,000 and $4,226,000 during the years ended November 30, 2005 and 2004, respectively. Interest on these deposits totaled $99,000 at an average annual rate of 2.34 percent for the year ended November 30, 2005 and $62,000 at an average annual rate of 1.47 percent for the year ended November 30, 2004.

At November 30, 2005, Accounts payable, accrued expenses and other liabilities included federal income taxes due from Morgan Stanley of $973,000. At November 30, 2004, Accounts payable, accrued expenses and other liabilities included federal income taxes due to Morgan Stanley of $21,752,000. At November 30, 2005 and 2004, Accounts payable, accrued expenses and other liabilities included certain state income taxes payable to Morgan Stanley, which have yet to be quantified and segregated from the income taxes payable directly to the states.

Included in Accounts payable, accrued expenses and other liabilities was accrued interest on notes payable to parent and affiliates of $6,469,000 and $947,000 at November 30, 2005 and 2004, respectively. Also included in Accounts payable, accrued expenses and other liabilities was accrued interest on certificates of deposit payable to parent and affiliates of $8,000 and $5,000 at November 30, 2005 and 2004, respectively.

DFSL provides the Bank with marketing, transaction processing, and other support services, primarily related to the credit card business. DFSL also provides the Bank with access to its proprietary merchant network. The costs associated with these activities and services are included in Information processing and other-Noninterest expenses and amounted to $2.0 billion and $1.9 billion for the years ended November 30, 2005 and 2004, respectively. Included in the fiscal 2005 expense is the Bank's portion of senior management compensation charges. In fiscal 2005, NCSI incurred a $29 million expense for certain members of senior management related to severance and new hires. Since this expense applies to all of the various participating NCSI companies, the Bank was allocated a portion of this expense.

The Bank receives interchange from DFSL for cardmember transactions processed through its proprietary merchant network, Discover Network. Interchange is included in Net interchange, cardmember and other-Noninterest revenues and amounted to $1.1 billion for each of the years ended November 30, 2005 and 2004.

MSCC provides transaction processing and other support services related to consumer loan products. The costs of providing these services are included in Information processing and other – Noninterest expenses and amounted to $4,639,000 and $5,880,000 for the years ended November 30, 2005 and 2004, respectively.

In May 2003, the Bank entered into an agreement with MSCC to periodically sell consumer loan products currently serviced by MSCC that meet specific criteria. During fiscal 2005 and 2004, these sales of consumer loans totaled $119,168,000 and $236,567,000, respectively. The Bank received proceeds on these sales of $125,282,000 and $246,240,000 during fiscal 2005 and 2004, respectively. The resulting gains of $6,114,000 and $9,673,000 for the years ending November 30, 2005 and 2004, respectively, are included in Net interchange, cardmember and other-Noninterest revenues.

The Bank paid brokerage commissions to Morgan Stanley & Co. Inc. for the sale of certificates of deposit. These commissions totaled $47,008,000 and $6,142,000 for the years ended November 30, 2005 and 2004, respectively, and are amortized to interest expense over the lives of the related certificates of deposit. Prepaid commission on these certificates of deposit at November 30, 2005 and 2004 was $51,282,000 and $36,487,000, respectively. Amortization of such commissions was $32,213,000 and $25,993,000 for the years ended November 30, 2005 and 2004, respectively. The Bank also paid commissions of $612,500 to Morgan Stanley & Co. International Limited for the sale of bank notes during the year ended November 30, 2004. No additional bank notes were issued in the year ended November 30, 2005. Prepaid commission on these bank notes at November 30, 2005 and 2004 was $391,000 and $514,000, respectively. Amortization of such commissions was $123,000 and $98,000 for the years ended November 30, 2005 and 2004, respectively.

The Bank paid underwriting fees on credit card asset securitizations to Morgan Stanley & Co. Inc. of $8,439,000 and $4,081,000 for the years ended November 30, 2005 and 2004, respectively. Amortization of such underwriting fees was $8,421,000 and $9,065,000 for the years ended November 30, 2005 and 2004, respectively and was included in Servicing and securitization income – Noninterest revenues. Deferred underwriting fees associated with these expenses were $16,938,000 and $16,920,000 for the years ended November 30, 2005 and 2004, respectively.

8. EMPLOYEE COMPENSATION AND BENEFITS

Substantially all employees of the Bank are eligible to participate in a multi-employer non-contributory defined benefit pension plan (the "Plan") for employees of NCSI and its subsidiaries, after meeting certain age and service requirements. Pension benefits are based on each employee's years of credited service and compensation levels specified in the Plan.

Since the Plan includes employees of the various participating NCSI companies, detailed benefit and asset information on an individual company basis is not available. The Bank expensed $1,792,000 and $1,707,000 for the years ended November 30, 2005 and 2004, respectively, related to this Plan. As the Plan is for the various participating NCSI companies, all liabilities for the Plan are recorded at NCSI. The Bank transferred to NCSI $1,785,000 and $2,503,000 for its share of accrued pension liability at November 30, 2005 and 2004, respectively.

The Bank has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees, employees and dependents. Eligibility for retiree medical and life insurance benefits is generally based on a combination of age and years of service at retirement. The Bank and the employee share the cost of coverage. For the years ended November 30, 2005 and 2004, the Bank recorded postretirement benefits expense of $343,000 and $387,000, respectively.

Employees of the Bank are eligible to participate in the Morgan Stanley 401(k) plan (the "START Plan") upon meeting certain eligibility requirements. Morgan Stanley matches a portion of each participant's contribution based upon the performance of Morgan Stanley and certain formulas as defined by the START Plan. For the years ended November 30, 2005 and 2004, the Bank's allocated expense was $1,245,000 and $970,000, respectively.

9. INCOME TAXES

The following is a summary of the provision for federal, state and deferred income taxes for the years ended November 30, 2005 and 2004:

	2005	2004
	(In thousands)	
Current tax expense:		
Federal	$ 354,254	$ 416,466
State	24,542	32,804
Deferred income tax expense	(52,755)	(14,240)
Total	$ 326,041	$ 435,030

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. The components of the Bank's net deferred income taxes at November 30, 2005 and 2004 are as follows:

	2005	2004
	(In thousands)	
Deferred income tax assets	$ 347,354	$ 373,286
Deferred income tax liabilities	(235,389)	(314,163)
Deferred income taxes - asset	$ 111,965	$ 59,123

Deferred income tax assets result primarily from use of the direct charge-off method for loan losses for tax purposes. Deferred income tax liabilities relate principally to capitalized net excess securitization gains and various cardmember fees, which are recognized currently for financial accounting purposes, but are recognized over time for tax purposes.

The Bank's combined federal and state effective tax rates were 36.6 percent for the year ended November 30, 2005 and 36.4 percent for the year ended November 30, 2004.

Income Tax Examinations **-** The Bank is under continuous examination by the Internal Revenue Service and the tax authorities for various states. The Bank regularly assesses the likelihood of additional assessments in each of the taxing jurisdictions resulting from tax examinations. Tax reserves have been established for assessments, which the Bank believes to be probable and estimable. Once established, reserves are adjusted when a better estimate of potential additional assessments is available. The resolution of tax matters will not have a material effect on the financial condition of the Bank, although a resolution could have a material impact on the Bank's consolidated statement of income for a particular future period and on the Bank's effective tax rate.

10. REGULATORY CAPITAL REQUIREMENTS

The Bank is subject to various regulatory capital requirements as administered by the FDIC. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items, as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of November 30, 2005, that the Bank meets all capital adequacy requirements to which it is subject.

As of November 30, 2005 and 2004, the most recent notification from the FDIC categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank's category.

In addition to the Bank's capital adequacy requirements, actual capital amounts and ratios for the years ended November 30, 2005 and 2004 are presented in the following table:

	Actual		For Capital Adequacy Purposes (1)		To Be Classified as Well-Capitalized Under Prompt Corrective Action Provisions	
Dollars in Thousands	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of November 30, 2005:						
Total capital (to risk-weighted assets)	$3,565,854	14.3 %	$1,999,618 ≥	8.0%	$2,499,523 ≥	10.0%
Tier I capital (to risk-weighted assets)	3,209,211	12.8 %	999,809 ≥	4.0%	1,499,714 ≥	6.0%
Tier I capital (to average assets)	3,209,211	14.3 %	671,810 ≥	3.0%	1,119,684 ≥	5.0%
As of November 30, 2004:						
Total capital (to risk-weighted assets)	$3,178,492	12.9 %	$1,970,197 ≥	8.0%	$2,462,746 ≥	10.0%
Tier I capital (to risk-weighted assets)	2,818,279	11.4 %	985,098 ≥	4.0%	1,477,648 ≥	6.0%
Tier I capital (to average assets)	2,818,279	15.1 %	559,080 ≥	3.0%	931,800 ≥	5.0%

(1) The minimum Tier I capital (to average assets) regulatory requirement can be higher based on the Bank's CAMELS rating and growth.

The amount of dividends that a bank may pay in any year is subject to certain regulatory restrictions. Under the current banking regulations, a bank may not pay dividends if such a payment would leave the bank inadequately capitalized. The Bank paid dividends from retained earnings of $175 million in fiscal 2005 and $637 million in fiscal 2004.

Morgan Stanley maintains certain credit facilities to support the issuance of commercial paper and general liquidity requirements. These facilities require that the Bank maintain certain minimum net worth levels equivalent to the Bank's regulatory requirements. At November 30, 2005 and 2004, the Bank was in compliance with these requirements.

11. CONTINGENCIES

The Bank is involved from time to time in various legal proceedings that arise in the ordinary course of its business. While there can be no assurance about the outcome of litigation in which the Bank is involved and the consequences of the Bank's litigation are not presently determinable, it is the opinion of management, based on consultation with counsel and currently available information, that the litigation will not have a materially adverse effect on the financial position of the Bank.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

To obtain fair values, observable market prices are used if available. In some instances, observable market prices or market parameters are not readily available for all products and fair value is determined using techniques appropriate for each particular product. These techniques involve some degree of judgment. Accordingly, these estimates are not necessarily indicative of the amounts the Bank could realize in a current market exchange. The use of different assumptions or estimation methodologies may have a material effect on the estimated fair value amounts.

The following presents the estimated fair value of financial instruments at November 30, 2005 and 2004:

(In thousands)

FINANCIAL ASSETS	2005		2004	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
CASH AND CASH EQUIVALENTS	$ 288,075	$ 288,075	$ 255,367	255,367
FEDERAL FUNDS SOLD	250,000	250,000	500,000	500,000
INVESTMENT SECURITIES				
Held-to-maturity	12,365	12,269	9,419	9,504
Available-for-sale	2,362	2,362	2,603	2,603
NET CONSUMER LOANS	19,796,802	19,988,610	17,956,060	18,891,756
AMOUNTS DUE FROM ASSET SECURITIZATIONS	1,084,262	1,084,262	884,190	884,190
FINANCIAL LIABILITIES				
DEPOSITS	16,047,312	15,995,073	12,934,473	13,056,608
NOTES PAYABLE AND OTHER BORROWINGS	1,315,298	1,315,298	2,985,277	2,985,277

At November 30, 2005 and 2004, a portion of the Bank's assets and liabilities are recorded at fair value or at amounts that approximate fair value. Such assets and liabilities include: Cash and cash equivalents, Federal funds sold, other short term liabilities and certain Investment securities and other assets (including certain retained interests in Amounts due from asset securitizations associated with the Bank's credit card asset securitizations).

Following are the techniques utilized in estimating the fair value of certain other assets and liabilities:

Investment Securities – The fair value of available-for-sale and certain held-to-maturity investment securities is based on quoted market prices.

Consumer Loans – The fair value of consumer loans is determined by discounting cash flows using current market rates of loans having similar characteristics. The cash flow calculation methodologies, which vary by product, include adjustments for credit risk and prepayment rates commensurate with recent and projected trends. The estimated fair value of the Bank's consumer loans approximated carrying value at November 30, 2005 and November 30, 2004.

Deposits – The fair value of the Bank's deposits is estimated by discounting future cash flows of the remaining maturities using market rates currently offered for deposits with similar maturities. At November 30, 2005 and November 30, 2004, fair value approximated carrying value.

At November 30, 2005, Investment securities held-to-maturity had the following maturities:

	(In thousands)
2011 - 2015	$ 126
2016 and thereafter	12,239
Total	$ 12,365

At November 30, 2005, the Bank did not have any investments in debt securities classified as available-for-sale.

The Bank's interest rate risk management program is designed to reduce the volatility of earnings resulting from changes in interest rates by having a financing portfolio that reflects the existing repricing schedules of consumer loans as well as the Bank's right, with notice to cardmembers, to reprice certain fixed rate consumer loans to a new interest rate in the future. To the extent that asset and related financing repricing characteristics of a particular portfolio are not matched effectively, the Bank utilizes interest rate contracts to achieve its objective. Interest rate contracts are derivative financial instruments that are entered into with institutions that are established dealers and that maintain certain minimum credit criteria established by the Bank.

At November 30, 2005, the Bank had interest rate swap agreements with a notional amount outstanding of $1,220,500,000, including $385,500,000 that were entered into during fiscal 2005. At November 30, 2004, the notional amounts of outstanding agreements were $845,000,000. The net fair values of agreements outstanding at November 30, 2005 were $35,535,000 of which $39,000 was recorded in Other assets and $35,574,000 was recorded in Accounts payable, accrued expenses and other liabilities. The net fair values of agreements at November 30, 2004 were $16,294,000 of which $1,061,000 was recorded in Other assets and $17,355,000 was recorded in Accounts payable, accrued expenses and other liabilities. Certain of these agreements were with affiliates. At November 30, 2005 and 2004, the notional amounts of agreements with affiliates were $975,500,000 and $600,000,000, respectively. The net fair value of agreements with affiliates at November 30, 2005 were $25,031,000 of which $39,000 was recorded in Other assets and $25,070,000 was recorded in Accounts payable, accrued expenses and other liabilities. The net fair value of agreements outstanding with affiliates at November 30, 2004 were $10,351,000 of which $1,061,000 was recorded in Other assets and $11,412,000 was recorded in Accounts payable, accrued expenses and other liabilities. At November 30, 2005, the interest rate swap agreements had maturities ranging from two to twenty years from the date of issuance and had a weighted average remaining maturity of approximately ten years.

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