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October 25, 2024

VIA EZFile

Brent Hassell  
Assistant Vice President  
The Federal Reserve Bank of Richmond  
P.O. Box 27622  
Richmond, VA 23261

Re: Additional Information Regarding Application by Capital One Financial Corporation to Acquire Discover Financial Services (the “Additional Information Request”)

We are submitting this letter and the related exhibits in response to your request for additional information, dated September 27, 2024, regarding the application seeking the prior approval of the Board of Governors of the Federal Reserve System (the “Federal Reserve”) for Capital One Financial Corporation (“Capital One”), the parent of Capital One, National Association, to acquire Discover Financial Services (“Discover”) and thereby acquire control of its subsidiary bank, Discover Bank (the “Application”). For ease of reference, your questions are included in bold with the responses immediately following. Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the Application.

Brent Hassell  
The Federal Reserve Bank of Richmond  
October 25, 2024  
Page 2

\* \* \*

Confidential treatment is being requested under the federal Freedom of Information Act, 5 U.S.C. § 552 (the “FOIA”), and the implementing regulations of the Board of Governors of the Federal Reserve System (the “Federal Reserve”), for the information contained in the Confidential Exhibits Volume to this letter (the “Confidential Materials”). The Confidential Materials include, for example, information regarding the business strategies and plans of (1) Capital One Financial Corporation (“COFC”), Vega Merger Sub, Inc. (“Merger Sub”) and Capital One, National Association (“CONA”) and (2) Discover Financial Services (“Discover”) and Discover Bank, and other information regarding additional matters of a similar nature, which is commercial or financial information that is both customarily and actually treated as private by COFC, Merger Sub, CONA, Discover and Discover Bank and provided to the government under an assurance of privacy. Certain information in the Confidential Materials also includes confidential supervisory information, which is protected from disclosure. None of this information is the type of information that would otherwise be made available to the public under any circumstances. All such information, if made public, could result in substantial and irreparable harm to COFC, Merger Sub, CONA, Discover and Discover Bank. Other exemptions from disclosure under the FOIA may also apply. In addition, investors and potential investors could be influenced or misled by such information, which is not reported in any documents filed or to be filed in accordance with the disclosure requirements of applicable securities laws, as a result of which COFC, Merger Sub, CONA, Discover and Discover Bank could be exposed to potential inadvertent violations of law or exposure to legal claims. Accordingly, confidential treatment is respectfully requested for the Confidential Materials under the FOIA and the Federal Reserve’s implementing regulations.

Please contact the undersigned (212-403-1354), Matthew T. Carpenter (212-403-1031) or Ledina Gocaj (212-403-1022) before any public release of any of this information pursuant to a request under the FOIA or a request or demand for disclosure by any governmental agency, congressional office or committee, court or grand jury. Such prior notice is necessary so that COFC, Merger Sub, CONA, Discover and Discover Bank may take appropriate steps to protect such information from disclosure.

If you have any questions about this submission or confidential treatment request, please do not hesitate to contact me.

Very truly yours,



Richard K. Kim

Brent Hassell  
The Federal Reserve Bank of Richmond  
October 25, 2024  
Page 3

Enclosures

cc (by email):

Patricia Roberts, Office of the Comptroller of the Currency  
([patricia.roberts@occ.treas.gov](mailto:patricia.roberts@occ.treas.gov))

Jeffrey Ralston, Federal Deposit Insurance Corporation  
([jralston@fdic.gov](mailto:jralston@fdic.gov))

Lisa Collison, Delaware Office of the State Bank Commissioner  
([lisa.collison@delaware.gov](mailto:lisa.collison@delaware.gov))

Matthew M. Guest, Wachtell, Lipton, Rosen & Katz  
Brandon C. Price, Wachtell, Lipton, Rosen & Katz  
Matthew T. Carpenter, Wachtell, Lipton, Rosen & Katz  
Ledina Gocaj, Wachtell, Lipton, Rosen & Katz

**Capital One Financial Corporation Public Responses to Additional Information Request  
from the Federal Reserve Bank of Richmond, dated September 27, 2024**

**1. Discuss what changes Capital One would make to its controls for monitoring the resulting institution’s compliance with sections 23A and 23B of the Federal Reserve Act and the Board’s Regulation W.**

Capital One has implemented an enterprise Regulation W compliance program to adhere to and support compliance with sections 23A and 23B of the Federal Reserve Act and the Federal Reserve Board’s Regulation W, and will continue to leverage this program post-Legal Day 1 (“LD1”). Capital One’s Regulation W compliance program includes: (i) the Regulation W Policy, as well as related Regulation W standards and procedures, which together define roles and responsibilities; (ii) formal controls that are documented in Capital One’s risk management system of record and tested on a periodic basis; and (iii) an annual training program for associates that could be affected by Regulation W requirements. Capital One reports the details of any covered transactions, as applicable, to the Federal Reserve Board as of the last calendar day of March, June, September and December of each year on Form FR Y-8.

As part of its integration planning, Capital One has placed special focus on any necessary changes to its Regulation W compliance program as of LD1 and thereafter and, to that end, has established a specific integration project plan for Regulation W. In support of the integration project plan, Capital One leveraged experts, both internally and externally, who are knowledgeable about the types of affiliate transactions that will occur between CONA and its affiliates, including the affiliated entities operating Discover’s various networks, beginning on LD1. The plan status is periodically reported to Capital One’s Finance Integration Management Office.

On LD1, Capital One will apply its Regulation W compliance program to Discover’s affiliate transactions and will begin to integrate Discover’s Regulation W policies, standards, processes and controls. As part of this integration, Capital One will further assess whether legacy Discover internal controls in place are consistent with Capital One’s risk framework. Capital One’s assessment will cover risk management practices, as well as talent and skills sets across Discover’s and Capital One’s three lines of defense, and may result in enhancements, conforming changes or other modifications to Discover’s existing policies, procedures and risk management activities, including monitoring and control activities, to conform with Capital One’s standards and those of its regulators.

Capital One expects that most of Discover’s intercompany agreements will remain effective on LD1 by operation of law. Capital One will, however, amend or terminate intercompany agreements, as appropriate to reflect, among other things, the legal entity wherein associates reside, changes to intercompany servicing relationships or funding needs, and to address any identified gaps.

**2. Discuss what changes Capital One would make to its Transactions with Affiliates policies and procedures for Regulation W compliance of the resulting institution. In your response, include any identified, or expected to be identified, covered**

**transactions under section 23A of the Federal Reserve Act and the Board's Regulation W involving DFS Services LLC and/or other nonbank entities of Discover.**

Capital One will continue to apply its Regulation W Policy and procedures on and following LD1. The acquisition of Discover's nonbank entities, including DFS Services LLC, will, however, require enhancements to Capital One's existing policies and procedures that address compliance with Regulation W, and Capital One will assess which elements of Discover's existing policies and procedures should be incorporated into Capital One's policies and procedures. Any such enhancements will be determined during the integration process.

Capital One's Regulation W Policy requires a review of all transactions between CONA and its affiliates for compliance with 23A and 23B requirements. When there is a proposed transaction between CONA and an affiliate, Capital One analyzes whether the transaction is a Covered Transaction (as defined by section 23A of the Federal Reserve Act and the Federal Reserve Board's Regulation W), whether an exemption applies, and if the transaction requires compliance with Section 23B (market terms). Covered Transactions are infrequent at Capital One and often fall under Regulation W's available exemptions.

Similarly, Capital One understands that Discover Bank does not enter into Covered Transactions in the ordinary course, but that controls are in place to ensure that any Covered Transaction that does occur complies with Regulation W. In cases where a Covered Transaction occurs, Capital One understands that such Covered Transactions are not material and are sufficiently covered by a cash collateral account established by Discover for the purpose of complying with 23A requirements, except as described further in the response to Question 4.

**3. Discuss how the proposed transaction would impact liquidity and liquidity risk management practices of Capital One, particularly with respect to the payment service operations of the target organization.**

Please see Confidential Exhibit 1.

**4. Discuss what changes Capital One would make, if any, to how the performance of functions related to the operation of Discover card payment network is divided between Discover Bank, on the one hand, and Discover's nonbank subsidiaries, on the other hand. In your response, provide the following items:**

- a. With reference to Chart A and Chart B from Discover's Annual Report for the year ended December 31, 2023, included in the Appendix, provide the following:**
  - i. For each activity or action described, identify the Discover legal entity currently responsible for such activity or action.**
  - ii. Describe further the specific activities involved in each step outlined in Chart A and Chart B.**

- iii. **Describe in detail all interactions between Discover’s nonbank subsidiaries and Discover Bank.**
- iv. **Provide the above information for Capital One and CONA following consummation of the proposal as currently contemplated.**

Please see Confidential Exhibit 1.

- b. **To the extent not already described, in reference to the bottom-left box of Chart A, describe in detail the interaction between the Discover card payment network and Discover Bank for a card transaction. Your response should clearly explain or illustrate the flow of funds at each step of this stage, parties involved including any Federal Reserve payment service systems, payment time periods or intervals, debits and credits, and any other key aspects in the payment, clearance, and settlement process. In addition, explain whether such processes can result in extensions of credit, or other covered transactions, under sections 23A and 23B of the Federal Reserve Act and the Board’s Regulation W. Clarify how, if at all, your responses would differ if the Merchant (top-right box) is a Capital One Shopping entity.**

Please see Confidential Exhibit 1.

**5. With respect to Capital One’s resolution planning:**

- a. **Elaborate on the legal entity and business line structure of Capital One post-merger and how the structure would support the firm’s preferred resolution strategy, minimize risk to U.S. financial stability in the event of the firm’s failure, and promote separability. In addition, discuss what legal entity rationalization and separability principles would drive corporate entity and business line structuring decisions.**

Capital One’s legal entity and business line structure following the transaction will balance various objectives, including: (a) having a straightforward legal entity organization that supports legal, regulatory and tax compliance; (b) aligning business operations with management expertise; (c) appropriately separating card issuing and network functions; (d) facilitating Capital One’s resolution strategy and resolvability should a failure event occur; and (e) maintaining existing organizational structures where possible during the initial integration to manage change.

With regard to legal entity structure, Capital One’s current intention is to:

- Merge Discover Bank into CONA, thereby maintaining a single insured depository institution under which the significant majority of Capital One’s business and financial activities will occur following closing of the Proposed Transaction.
- Following closing, evaluate whether the activities performed by Discover’s service level legal entities, primarily DFS Corporate Services LLC and Discover Products Inc., can

and should be consolidated into Capital One's main service level entity, Capital One Services, LLC (a subsidiary of CONA).

- Maintain Discover's primary network operating subsidiary, DFS Services LLC (which, together with its subsidiaries, manages Discover's credit and debit networks and international card acceptance operations), as a direct subsidiary of Capital One Financial Corporation. This organizational structure is consistent with how Discover and other bank holding companies have maintained their credit and debit networks over time and maintains an important and appropriate management separation as well as independence of the network operating functions from the card issuing bank functions. This organizational structure is important to maintain separate leadership and decision-making authority for the network on behalf of network participants, including merchants and other issuing banks, as well as to provide suitable information confidentiality and separation practices relating to information regarding the Discover payment networks and other payment networks that interact with CONA.

The above legal entity structure provides both business-as-usual and resolution strategy execution efficiencies. In particular, with respect to resolution planning and Capital One's current multiple-point-of-entry resolution strategy, the described structure creates the following advantages:

- Capital One would maintain only one insured depository institution, CONA, which will continue to comprise the substantial majority of Capital One's consolidated business and financial activities;
- Capital One would continue to have a small number of material entities for resolution planning purposes, providing important operational, separation and management oversight efficiencies during resolution;
- Capital One will continue to have limited international balance sheet exposures, which will primarily consist of, as is the case today, Capital One's international card businesses;
- Discover's card issuing business would be included in Capital One's existing resolution planning process and benefit from those resources and Capital One's existing framework and experience with managing and transferring card relationships and receivables; and
- The network operations would be maintained under a separate legal entity, facilitating resolution optionality for disposition either separately from or together with the disposition of the combined company's card business.

Moreover, Capital One maintains a Legal Entity Governance Program, whereby Capital One regularly reviews its legal entity structure. In order to provide for a streamlined and well-managed corporate structure, Capital One has a steering committee to oversee the legal entity formation and dissolution decision-making process. The Legal Entity Management Standard, which guides the work of the steering committee, formalizes the process for enhancements to the existing legal entity structure or operating procedures, such as indicating the level of business

owner oversight required and establishing roles and responsibilities for governance and day-to-day management of legal entities. Capital One's Legal Entity Governance Program reduces operational complexity and risk by (i) eliminating duplicative processes, policies, governance structures, and systems; (ii) simplifying corporate processes (e.g., capital, liquidity, resolution and recovery planning, intercompany transactions, budgeting); and (iii) guiding the legal entity aspects of future operational changes. These structural reductions in complexity also directly and indirectly facilitate resolution readiness by facilitating continuity of services and the ability to separate businesses and operations.

Capital One's legal entity rationalization process has resulted in prior enhancements to Capital One's resolvability, including the October 2022 consolidation of Capital One Bank (USA), N.A. into CONA and the January 2019 combination of Capital One's primary service level entities, resulting in a simplified organizational structure with one insured depository institution and one primary service level entity sitting beneath it (Capital One Services, LLC).

Capital One will continue to use its legal entity rationalization strategy and process following closing of the Proposed Transaction. As the integration planning process progresses, there may be opportunities for simplifying the initial post-transaction legal entity structure or considering other changes.

Certain decisions regarding Capital One's post-transaction legal entity and business line structure have not been finalized at this time. Integration planning remains ongoing and subsequent information or decisions may potentially change or refine this response.

Capital One's management experience and financial, business and risk management strengths, together with a well-managed resolution planning process are designed to minimize the potential occurrence of a failure and to facilitate an orderly resolution from it, if necessary.

Additional information is provided in the confidential portion of this response. Please see Confidential Exhibit 1.

- b. To the extent not already provided, clarify whether Capital One intends to operate Discover's card payment network through nonbank subsidiaries of Capital One (rather than operated solely through CONA). If so, explain the business rationale for this intended structure and discuss the impact of this structure on the resolvability of the resulting organization.**

Please see the response to Question 5(a) for additional information. Further information is provided in Confidential Exhibit 1.

- 6. Discuss credit performance of domestic credit card receivables by vintage in terms of delinquencies and net charge offs for CONA and Discover Bank as of August 31, 2024, and for the combined bank on a pro forma basis. Your discussion should include aspects of performance that are unfavorable relative to historical averages or management expectations. In addition, discuss projected credit performance post-**



**merger for year-end 2025, 2026, and 2027, and expected impact to net income and regulatory capital. Your discussion should include credit risk mitigants as well as any expected significant increases in allowance for credit losses relative to historical experience.**

Please see Confidential Exhibit 1.

- 7. Broadly discuss any credit performance deterioration associated with Capital One's auto lending business and management expectations over the next three years.**

Please see Confidential Exhibit 1.

- 8. Provide current and pro forma asset and liability concentrations for CONA relative to tier 1 capital plus allowance for credit losses, as of June 30, 2024.**

- a. Provide further breakdown of current and pro forma concentrations by subprime/non-subprime across domestic credit card and auto loan portfolios.**
- b. Discuss key processes that are currently employed and/or whether any enhancements are needed to effectively monitor and manage any asset or liability concentrations following the proposed bank merger. This may include any de-risking initiatives or recalibration of lending thresholds or risk tolerance limits.**
- c. Provide current and pro forma asset (major loan products) and liability (major funding/deposit products) composition mix for CONA and discuss any meaningful change relative to the bank's current balance sheet, as of June 30, 2024.**

Please see Confidential Exhibit 1.

- 9. Provide asset quality ratios (with relevant calculations) for Capital One and CONA on a consolidated and bank-only basis, using current and pro forma balance sheets as of June 30, 2024. The asset quality analysis should include the following:**

- a. Focus on two separate elements: (i) internally classified assets comprised of the separate categories of substandard, doubtful, and loss (with relevant components of other real estate owned ("OREO") separately identified in each category), and (ii) nonperforming assets, comprised of nonaccrual loans, all restructured and modified loans, and OREO.**
- b. For the classified assets ratio, the level of classified assets should be compared to the total amount of tier 1 capital and allowance for credit losses.**

- c. **For the nonperforming assets ratio, the level of nonperforming assets should be compared to the total equity capital and the allowance for credit losses.**

Please see Confidential Exhibit 5.

10. **Provide loan loss reserve coverage ratios (with relevant calculations) for Capital One and CONA on a consolidated and bank-only basis, using current and pro forma balance sheets as of June 30, 2024. The coverage ratios should include the following:**
  - a. **For Capital One, for the numerator use the total allowance for credit losses and for the denominator use nonaccrual loans and loans past due more than 90 days.**
  - b. **For CONA, for the numerator use the total allowance for credit losses and for the denominator use nonaccrual loans.**

Please see Confidential Exhibit 5.

11. **Provide balance sheets and income statements for DFS Services and DFS Corporate Services, LLC, Riverwoods, Illinois, as of June 30, 2024.**

Please see Confidential Exhibit 6.

12. **Describe how Capital One and Discover each identify a credit card account as a post-secondary student credit card account. Indicate which, if any, account attributes (e.g., credit card product, accountholder FICO score, age, location, enrollment status) Capital One or Discover each use to identify whether an account is a post-secondary student credit card account.**

Please see Confidential Exhibit 1.

13. **For purchase volumes, outstandings, and number of accounts, recompute the volume of commerce, market shares, change in HHI, post-merger HHI and combined share from Confidential Annex 4 to Confidential Exhibit J<sup>1</sup> of the Section 3 Application (using the same data or a comparable source), now conditional on post-secondary student credit card accounts. Provide the data underlying these calculations.**

Please see Confidential Exhibit 1.

14. **Describe how Capital One and Discover each identify credit card accounts as ones with little to no credit history (sometimes referred to as “thin file” customers) or as ones with invalid FICO scores. Indicate which, if any, account attributes (e.g., credit card product, accountholder FICO score, age, location, age of oldest account) Capital**

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<sup>1</sup> In response to a request under the Freedom of Information Act, Capital One confirmed that Confidential Annex 4 could be disclosed in full and submitted a revised version of Public Exhibit 21, which included Confidential Annex 4.

**One or Discover each use to identify a credit card account with little to no credit history or with an invalid FICO score.**

Please see Confidential Exhibit 1.

- 15. For purchase volumes, outstandings, and number of accounts, recompute the volume of commerce, market shares, change in HHI, post-merger HHI and combined share from Confidential Annex 4 to Confidential Exhibit J of the Section 3 Application (using the same data or a comparable source), now conditional on credit card accounts with little to no credit history or invalid FICO scores. Provide the data underlying these calculations.**

Please see Confidential Exhibit 1.

- 16. Provide a summary discussion as to how the proposed transaction would increase consolidated profitability for the three years following consummation of the proposed transaction. Identify the primary factors that would drive or enable profits and any underlying assumptions.**

The proposed transaction is expected to drive improvement in profitability for the consolidated company. As announced on February 19, 2024, Capital One expects adjusted non-GAAP earnings per share accretion of more than 15% in 2027 as synergies are realized.

For additional information please see Confidential Exhibit 1.