ALLIANCE DATA SYSTEMS CORP
Form 10-Q
November 05, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

OR

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-15749

ALLIANCE DATA SYSTEMS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	31-1429215
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7500 Dallas Parkway, Suite 700
Plano, Texas 75024
(Address of principal executive office, including zip code)

(214) 494-3000
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes R No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer R	Accelerated filer £
Non-accelerated filer £ (Do not check if a smaller reporting company)	Smaller reporting company £

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No R

As of October 30, 2013, 48,712,675 shares of common stock were outstanding.

ALLIANCE DATA SYSTEMS CORPORATION

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PART I

Item 1. Financial Statements.

ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2013	December 31, 2012
	(In thousands, except per share amounts)	
ASSETS		
Cash and cash equivalents	$ 784,042	$ 893,352
Trade receivables, less allowance for doubtful accounts ($2,505 and $3,919 at September 30, 2013 and December 31, 2012, respectively)	337,332	370,110
Credit card receivables:		
Credit card receivables – restricted for securitization investors	6,185,497	6,597,120
Other credit card receivables	1,271,848	852,512
Loan receivables held for sale	50,950	—
Total credit card receivables	7,508,295	7,449,632
Allowance for loan loss	(462,041)	(481,958)
Credit card receivables, net	7,046,254	6,967,674
Deferred tax asset, net	221,293	237,268
Other current assets	175,500	171,049
Redemption settlement assets, restricted	545,939	492,690
Total current assets	9,110,360	9,132,143
Property and equipment, net	276,097	253,028
Deferred tax asset, net	27,600	30,027
Cash collateral, restricted	33,842	65,160
Intangible assets, net	489,640	582,874
Goodwill	1,741,979	1,751,053
Other non-current assets	285,145	185,854
Total assets	$ 11,964,663	$ 12,000,139
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 258,254	$ 215,470
Accrued expenses	302,417	274,625
Deposits	1,138,905	1,092,753
Non-recourse borrowings of consolidated securitization entities	315,000	1,474,054
Current debt	355,499	803,269
Other current liabilities	132,598	117,283
Deferred revenue	1,001,582	1,055,323
Total current liabilities	3,504,255	5,032,777
Deferred revenue	178,743	193,738
Deferred tax liability, net	265,922	277,354
Deposits	1,171,602	1,135,658

Non-recourse borrowings of consolidated securitization entities		3,666,916		2,656,916
Long-term and other debt		2,327,813		2,051,570
Other liabilities		137,993		123,639
Total liabilities		11,253,244		11,471,652
Commitments and contingencies				
Stockholders' equity:				
Common stock, $0.01 par value; authorized, 200,000 shares; issued, 95,418 shares and 94,963 shares at September 30, 2013 and December 31, 2012, respectively		954		950
Additional paid-in capital		1,487,332		1,454,230
Treasury stock, at cost, 46,752 shares and 45,360 shares at September 30, 2013 and December 31, 2012, respectively		(2,689,177)		(2,458,092)
Retained earnings		1,931,557		1,553,260
Accumulated other comprehensive loss		(19,247)		(21,861)
Total stockholders' equity		711,419		528,487
Total liabilities and stockholders' equity	$	11,964,663	$	12,000,139

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(In thousands, except per share amounts)			
Revenues				
Transaction	$ 84,264	$ 74,904	$ 246,185	$ 235,150
Redemption	131,985	144,144	430,339	491,795
Finance charges, net	507,828	434,824	1,447,971	1,188,933
Database marketing fees and direct marketing services	334,720	225,303	939,821	658,429
Other revenue	37,650	32,317	113,660	95,239
Total revenue	1,096,447	911,492	3,177,976	2,669,546
Operating expenses				
Cost of operations (exclusive of depreciation and amortization disclosed separately below)	628,386	499,455	1,868,093	1,532,815
Provision for loan loss	90,976	81,250	215,420	183,129
General and administrative	33,845	24,584	84,392	76,115
Depreciation and other amortization	21,395	18,745	61,401	54,845
Amortization of purchased intangibles	33,077	22,987	99,497	65,009
Total operating expenses	807,679	647,021	2,328,803	1,911,913
Operating income	288,768	264,471	849,173	757,633
Interest expense				
Securitization funding costs	22,914	23,296	72,093	68,143
Interest expense on deposits	7,287	6,753	21,296	18,719
Interest expense on long-term and other debt, net	43,814	44,316	146,636	126,222
Total interest expense, net	74,015	74,365	240,025	213,084
Income before income tax	$ 214,753	$ 190,106	$ 609,148	$ 544,549
Provision for income taxes	81,875	70,561	230,851	205,954
Net income	$ 132,878	$ 119,545	$ 378,297	$ 338,595
Basic income per share	$ 2.73	$ 2.39	$ 7.69	$ 6.76
Diluted income per share	$ 2.01	$ 1.84	$ 5.63	$ 5.33
Weighted average shares				
Basic	48,710	49,939	49,199	50,086
Diluted	66,019	65,038	67,168	63,539

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Net income	$ 132,878	$ 119,545	$ 378,297	$ 338,595
Other comprehensive income, net of tax				
Net unrealized gain (loss) on securities available-for-sale, net of tax expense of $167, tax expense of $142, tax benefit of $(913) and tax expense of $26 for the three and nine months ended September 30, 2013 and 2012, respectively	50	3,044	(5,404)	4,880
Foreign currency translation adjustments	(247)	(2,107)	8,018	(3,767)
Other comprehensive (loss) income	(197)	937	2,614	1,113
Total comprehensive income, net of tax	$ 132,681	$ 120,482	$ 380,911	$ 339,708

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 378,297	$ 338,595
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	160,898	119,854
Deferred income taxes	4,668	76,356
Provision for loan loss	215,420	183,129
Non-cash stock compensation	43,428	37,605
Fair value gain on interest-rate derivatives	(8,511)	(22,672)
Amortization of discount on debt	57,900	60,915
Change in deferred revenue	(21,951)	(36,364)
Change in other operating assets and liabilities	19,691	120,091
Originations of loan receivables held for sale	(361,151)	—
Sales of loan receivables held for sale	310,201	—
Excess tax benefits from stock-based compensation	(12,492)	(15,237)
Other	12,440	(211)
Net cash provided by operating activities	798,838	862,061
CASH FLOWS FROM INVESTING ACTIVITIES:		
Change in redemption settlement assets	(73,803)	41,885
Change in cash collateral, restricted	32,405	101,536
Change in restricted cash	39,827	(43,892)
Change in credit card and loan receivables	(220,571)	(418,514)
Purchase of credit card portfolios	(37,056)	(780,153)
Capital expenditures	(91,759)	(77,340)

Purchases of marketable securities	(23,632)	(4,719)
Maturities/sales of marketable securities	1,639	3,227
Other	(1,383)	(10,587)
Net cash used in investing activities	(374,333)	(1,188,557)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under debt agreements	1,747,000	699,500
Repayments of borrowings	(1,171,428)	(500,428)
Proceeds from convertible note hedge counterparties	1,056,268	—
Repayments of convertible note borrowings	(1,861,239)	—
Issuances of deposits	1,278,687	1,185,049
Repayments of deposits	(1,196,591)	(703,173)
Non-recourse borrowings of consolidated securitization entities	1,633,285	1,672,962
Repayments/maturities of non-recourse borrowings of consolidated securitization entities	(1,782,339)	(1,418,133)
Payment of capital lease obligations	(13)	(16)
Payment of deferred financing costs	(22,371)	(30,930)
Excess tax benefits from stock-based compensation	12,492	15,237
Proceeds from issuance of common stock	8,539	15,119
Purchase of treasury shares	(231,085)	(65,358)
Net cash (used in) provided by financing activities	(528,795)	869,829
Effect of exchange rate changes on cash and cash equivalents	(5,020)	6,771
Change in cash and cash equivalents	(109,310)	550,104
Cash and cash equivalents at beginning of period	893,352	216,213
Cash and cash equivalents at end of period	$ 784,042	$ 766,317
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 167,729	$ 149,076
Income taxes paid, net	$ 158,294	$ 91,055

See accompanying notes to unaudited condensed consolidated financial statements.

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The unaudited condensed consolidated financial statements included herein have been prepared by Alliance Data Systems Corporation ("ADSC" or, including its wholly owned subsidiaries and its consolidated variable interest entities, the "Company"), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report filed on Form 10-K for the year ended December 31, 2012, filed with the SEC on February 28, 2013.

The unaudited condensed consolidated financial statements included herein reflect all adjustments (consisting of normal, recurring adjustments) which are, in the opinion of management, necessary to state fairly the results for the interim periods presented. The results of operations for the interim periods presented are not necessarily indicative of the operating results to be expected for any subsequent interim period or for the fiscal year.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect (1) the reported amounts of assets; (2) liabilities and disclosure of contingent assets and liabilities at the date of the financial statements; and (3) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Standards

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02, "Reporting Amounts Reclassified Out of Accumulated Other Comprehensive Income," which expands the disclosure requirements for items reclassified from accumulated other comprehensive income to net income by requiring the total changes of each component of other comprehensive income to be disaggregated and separately presenting current period reclassification adjustments from the remainder of other comprehensive income for the period. ASU 2013-02 is effective for interim and annual periods beginning after December 15, 2012 and requires prospective application. ASU 2013-02 had no impact on the Company's financial condition, results of operations or cash flows, but did add certain disclosure requirements. The related disclosures are presented in Note 9, "Accumulated Other Comprehensive Income."

In July 2013, the FASB issued ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," which provides guidance on financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. ASU 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward when settlement in this manner is available under the governing tax law. ASU 2013-11 is effective for interim and annual periods beginning after December 15, 2013 and requires prospective application. The Company does not expect the adoption of ASU 2013-11 to have a material impact on the Company's financial condition, results of operations or cash flows.

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

2. SHARES USED IN COMPUTING NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands, except per share amounts)			
Numerator:				
Net income	$ 132,878	$ 119,545	$ 378,297	$ 338,595
Denominator:				
Weighted average shares, basic	48,710	49,939	49,199	50,086
Weighted average effect of dilutive securities:				
Shares from assumed conversion of convertible senior notes	7,512	9,033	9,419	8,378
Shares from assumed conversion of convertible note warrants	9,141	5,263	7,937	4,317
Net effect of dilutive stock options and unvested restricted stock units	656	803	613	758
Denominator for diluted calculations	66,019	65,038	67,168	63,539
Basic net income per share	$ 2.73	$ 2.39	$ 7.69	$ 6.76
Diluted net income per share	$ 2.01	$ 1.84	$ 5.63	$ 5.33

The Company calculates the effect of its convertible senior notes, which can be settled in cash or shares of common stock, on diluted net income per share as if they will be settled in cash as the Company has the intent to settle the convertible senior notes for cash.

Concurrently with the issuance of its convertible senior notes, the Company entered into hedge transactions that are generally expected to offset the potential dilution of the shares from assumed conversion of convertible senior notes.

The Company is also party to prepaid forward contracts to purchase 1,857,400 shares of its common stock that are to be delivered over a settlement period in 2014. The number of shares to be delivered under the prepaid forward contracts is used to reduce weighted-average basic and diluted shares outstanding.

3. CREDIT CARD RECEIVABLES

The Company’s credit card receivables are the only portfolio segment or class of financing receivables. Quantitative information about the components of total credit card receivables is presented in the table below:

	September 30, 2013	December 31, 2012
	(In thousands)	
Principal receivables	$ 7,107,983	$ 7,097,951

Billed and accrued finance charges		313,195		291,476
Other receivables		87,117		60,205
Total credit card receivables		7,508,295		7,449,632
Less credit card receivables – restricted for securitization investors		6,185,497		6,597,120
Less loan receivables held for sale		50,950		—
Other credit card receivables	$	1,271,848	$	852,512

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

In August 2013, under agreements with subsidiaries of eBay, Inc., including PayPal, Inc. and Bill Me Later, Inc. (collectively, "eBay"), the Company became an issuer for eBay's Bill Me Later® credit products. After issuance, these loan receivables are transferred to eBay at par value plus accrued interest. These transfers qualify for sale treatment as they meet the conditions established in Accounting Standards Codification ("ASC") 860-10, "Transfers and Servicing." Following the sale, eBay owns the loan receivables, bears the risk of loss in the event of loan defaults and is responsible for all servicing functions related to the amounts. The loan receivables originated by the Company that have not yet been sold to eBay are included in loan receivables held for sale in the Company's unaudited condensed consolidated balance sheet at September 30, 2013 and carried at the lower of cost or fair value. The carrying value of these loan receivables approximates fair value due to the short duration between origination and sale. Purchases and sales of these loan receivables held for sale are reflected as operating activities in the Company's unaudited condensed consolidated statement of cash flow for the nine months ended September 30, 2013.

Upon eBay's purchase of the Bill Me Later loan receivables, the Company is obligated to purchase a participating interest in a pool of loan receivables that includes the Bill Me Later loan receivables originated by the Company. Such interest participates on a pro rata basis in the cash flows of the underlying pool of loan receivables, including principal repayments, finance charges, losses, recoveries, and servicing costs. The Company bears the risk of loss related to its participation interest in this pool. Through September 30, 2013, the Company had purchased $15.5 million of these loan receivables, of which $14.5 million was outstanding at September 30, 2013 and included in other credit card receivables in the Company's unaudited condensed consolidated balance sheet.

Allowance for Loan Loss

The Company maintains an allowance for loan loss at a level that is appropriate to absorb probable losses inherent in credit card receivables. The allowance for loan loss covers forecasted uncollectible principal as well as unpaid interest and fees. The allowance for loan loss is evaluated monthly for appropriateness.

In estimating the allowance for principal loan losses, management utilizes a migration analysis of delinquent and current credit card receivables. Migration analysis is a technique used to estimate the likelihood that a credit card receivable will progress through the various stages of delinquency and to charge-off. The allowance is maintained through an adjustment to the provision for loan loss. Charge-offs of principal amounts, net of recoveries are deducted from the allowance. In estimating the allowance for uncollectible unpaid interest and fees, the Company utilizes historical charge-off trends, analyzing actual charge-offs for the prior three months. The allowance is maintained through an adjustment to finance charges, net. In evaluating the allowance for loan loss for both principal and unpaid interest and fees, management also considers factors that may impact loan loss experience, including seasoning, loan volume and amounts, seasonality, payment rates and forecasting uncertainties.

Net charge-offs include the principal amount of losses from credit cardholders unwilling or unable to pay their account balances, as well as bankrupt and deceased credit cardholders, less recoveries and exclude charged-off interest, fees and fraud losses. Charged-off interest and fees reduce finance charges, net while fraud losses are recorded as an expense. Credit card receivables, including unpaid interest and fees, are charged-off at the end of the month during which an account becomes 180 days contractually past due, except in the case of customer bankruptcies or death. Credit card receivables, including unpaid interest and fees, associated with customer bankruptcies or death are charged-off at the end of each month subsequent to 60 days after the receipt of notification of the bankruptcy or death, but in any case, not later than the 180-day contractual time frame. The Company records the actual charge-offs for unpaid interest and fees as a reduction to finance charges, net. Actual charge-offs for unpaid interest and fees were $54.1 million and $44.3 million for the three months ended September 30, 2013 and 2012, respectively, and $167.8 million and $137.5 million for the nine months ended September 30, 2013 and 2012, respectively.

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

The following table presents the Company’s allowance for loan loss for the periods indicated:

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(In thousands)			
Balance at beginning of period	$ 448,396	$ 432,521	$ 481,958	$ 468,321
Provision for loan loss	90,976	81,250	215,420	183,129
Recoveries	26,204	22,088	84,152	74,802
Principal charge-offs	(103,535)	(87,309)	(319,489)	(277,702)
Other	—	(8)	—	(8)
Balance at end of period	$ 462,041	$ 448,542	$ 462,041	$ 448,542

Delinquencies

A credit card account is contractually delinquent if the Company does not receive the minimum payment by the specified due date on the cardholder’s statement. It is the Company’s policy to continue to accrue interest and fee income on all credit card accounts beyond 90 days, except in limited circumstances, until the credit card account balance and all related interest and other fees are paid or charged off, typically at 180 days delinquent. When an account becomes delinquent, a message is printed on the credit cardholder’s billing statement requesting payment. After an account becomes 30 days past due, a proprietary collection scoring algorithm automatically scores the risk of the account becoming further delinquent. The collection system then recommends a collection strategy for the past due account based on the collection score and account balance and dictates the contact schedule and collections priority for the account. If the Company is unable to make a collection after exhausting all in-house collection efforts, the Company may engage collection agencies and outside attorneys to continue those efforts. At September 30, 2013, the more than 30 and more than 90 days delinquency rates were 4.5% and 1.9%, respectively. At December 31, 2012, the more than 30 and more than 90 days delinquency rates were 4.0% and 1.7%, respectively.

Modified Credit Card Receivables

The Company holds certain credit card receivables for which the terms have been modified. The Company’s modified credit card receivables include credit card receivables for which temporary hardship concessions have been granted and credit card receivables in permanent workout programs. These modified credit card receivables include concessions consisting primarily of a reduced minimum payment and an interest rate reduction. The temporary programs’ concessions remain in place for a period no longer than twelve months, while the permanent programs remain in place through the payoff of the credit card receivables if the credit cardholder complies with the terms of the program. These concessions do not include the forgiveness of unpaid principal, but may involve the reversal of certain unpaid interest or fee assessments. In the case of the temporary programs, at the end of the concession period, credit card receivable terms revert to standard rates. These arrangements are automatically terminated if the customer fails to make payments in accordance with the terms of the program, at which time their account reverts back to its original terms.

Credit card receivables for which temporary hardship and permanent concessions were granted are both considered troubled debt restructurings and are collectively evaluated for impairment. Modified credit card receivables are evaluated at their present value with impairment measured as the difference between the credit card receivable balance and the discounted present value of cash flows expected to be collected. Consistent with the Company’s measurement of impairment of modified credit card receivables on a pooled basis, the discount rate used for credit card receivables is the average current annual percentage rate the Company applies to non-impaired credit card receivables, which approximates what would have been applied to the pool of modified credit card receivables prior to impairment. In assessing the appropriate allowance for loan loss, these modified credit card receivables are included in the general pool of credit card receivables with the allowance determined under the contingent loss model of ASC 450-20, "Loss Contingencies." If the Company applied accounting under ASC 310-40, "Troubled Debt Restructurings by Creditors," to the modified credit card receivables in these programs, there would not be a material difference in the allowance for loan loss.

The Company had $117.3 million and $117.0 million, respectively, as a recorded investment in impaired credit card receivables with an associated allowance for loan loss of $37.3 million and $39.7 million, respectively, as of September 30, 2013 and December 31, 2012. These modified credit card receivables represented less than 3% of the Company's total credit card receivables as of September 30, 2013 and December 31, 2012, respectively.

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

The average recorded investment in the impaired credit card receivables was $116.7 million and $111.7 million for the three months ended September 30, 2013 and 2012, respectively, and $117.2 million and $114.3 million for the nine months ended September 30, 2013 and 2012, respectively.

Interest income on these modified credit card receivables is accounted for in the same manner as other accruing credit card receivables. Cash collections on these modified credit card receivables are allocated according to the same payment hierarchy methodology applied to credit card receivables that are not in such programs. The Company recognized $3.2 million and $3.0 million for the three months ended September 30, 2013 and 2012, respectively, and $9.5 million and $9.1 million for the nine months ended September 30, 2013 and 2012, respectively, in interest income associated with modified credit card receivables during the period that such credit card receivables were impaired.

The following tables provide information on credit card receivables that are considered troubled debt restructurings as described above, which entered into a modification program during the specified periods:

	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Number of Restructurings	Pre-modification Outstanding Balance	Post-modification Outstanding Balance	Number of Restructurings	Pre-modification Outstanding Balance	Post-modification Outstanding Balance
	(Dollars in thousands)					
Troubled debt restructurings – credit card receivables	37,032	$ 34,169	$ 34,147	109,927	$ 100,270	$ 100,209

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Number of Restructurings	Pre-modification Outstanding Balance	Post-modification Outstanding Balance	Number of Restructurings	Pre-modification Outstanding Balance	Post-modification Outstanding Balance
	(Dollars in thousands)					
Troubled debt restructurings – credit card receivables	35,000	$ 31,267	$ 31,248	95,039	$ 85,422	$ 85,316

The tables below summarize troubled debt restructurings that have defaulted in the specified periods where the default occurred within 12 months of their modification date:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	Number of Restructurings	Outstanding Balance	Number of Restructurings	Outstanding Balance
	(Dollars in thousands)			
Troubled debt restructurings that subsequently defaulted – credit card	15,536	$ 14,874	46,729	$ 44,295

receivables

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2012	
	Number of Restructurings	Outstanding Balance	Number of Restructurings	Outstanding Balance
	(Dollars in thousands)			
Troubled debt restructurings that subsequently defaulted – credit card receivables	12,764	$ 12,363	41,971	$ 40,524

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

Age of Credit Card Receivables

The following tables set forth, as of September 30, 2013 and 2012, the number of active credit card accounts with balances and the related principal balances outstanding, based upon the age of the active credit card accounts from origination:

	September 30, 2013			
Age of Accounts Since Origination	Number of Active Accounts with Balances	Percentage of Active Accounts with Balances	Principal Receivables Outstanding (1)	Percentage of Principal Receivables Outstanding
	(In thousands, except percentages)			
0-12 Months	4,233	27.0%	$ 1,660,718	23.5%
13-24 Months	2,187	13.9	930,082	13.2
25-36 Months	1,514	9.7	684,463	9.7
37-48 Months	1,136	7.2	553,471	7.8
49-60 Months	931	5.9	500,259	7.1
Over 60 Months	5,694	36.3	2,728,040	38.7
Total	15,695	100.0%	$ 7,057,033	100.0%

(1) Excludes $51.0 million of loan receivables held for sale.

	September 30, 2012			
Age of Accounts Since Origination	Number of Active Accounts with Balances	Percentage of Active Accounts with Balances	Principal Receivables Outstanding	Percentage of Principal Receivables Outstanding
	(In thousands, except percentages)			
0-12 Months	3,838	25.7%	$ 1,388,049	22.2%
13-24 Months	1,944	13.0	733,807	11.7
25-36 Months	1,424	9.5	621,926	9.9
37-48 Months	1,139	7.6	565,294	9.0
49-60 Months	944	6.3	436,518	7.0
Over 60 Months	5,668	37.9	2,514,645	40.2
Total	14,957	100.0%	$ 6,260,239	100.0%

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

Credit Quality

The Company uses proprietary scoring models developed specifically for the purpose of monitoring the Company's obligor credit quality. The proprietary scoring models are used as a tool in the underwriting process and for making credit decisions. The proprietary scoring models are based on historical data and require various assumptions about future performance. Information regarding customer performance is factored into these proprietary scoring models to determine the probability of an account becoming 90 or more days past due at any time within the next 12 months. Obligor credit quality is monitored at least monthly during the life of an account. The following table reflects composition of the Company's credit card receivables by obligor credit quality as of September 30, 2013 and 2012:

Probability of an Account Becoming 90 or More Days Past Due or Becoming Charged-off (within the next 12 months)	September 30, 2013 Total Principal Receivables Outstanding (1)	September 30, 2013 Percentage of Principal Receivables Outstanding	September 30, 2012 Total Principal Receivables Outstanding	September 30, 2012 Percentage of Principal Receivables Outstanding
	(In thousands, except percentages)			
No Score	$ 144,336	2.0%	$ 290,008	4.6%
27.1% and higher	330,802	4.7	257,032	4.1
17.1% - 27.0%	669,535	9.5	545,755	8.7
12.6% - 17.0%	746,424	10.6	625,436	10.0
3.7% - 12.5%	2,819,112	39.9	2,521,231	40.3
1.9% - 3.6%	1,487,871	21.1	1,322,943	21.1
Lower than 1.9%	858,953	12.2	697,834	11.2
Total	$ 7,057,033	100.0%	$ 6,260,239	100.0%

(1) Excludes $51.0 million of loan receivables held for sale.

Credit Card Portfolio Acquisition

In March 2013, the Company acquired the existing private label credit card portfolio of Barneys New York. The total purchase price was $37.1 million and consisted of $35.3 million of credit card receivables and $1.8 million of intangible assets that are included in the September 30, 2013 unaudited condensed consolidated balance sheet.

Securitized Credit Card Receivables

The Company regularly securitizes its credit card receivables through its credit card securitization trusts. As of September 30, 2013, these trusts consisted of World Financial Network Credit Card Master Trust, World Financial Network Credit Card Master Note Trust ("Master Trust I") and World Financial Network Credit Card Master Trust III ("Master Trust III") (collectively, the "WFN Trusts"), and World Financial Capital Credit Card Master Note Trust (the "WFC Trust"). The Company continues to own and service the accounts that generate credit card receivables held by the WFN Trusts and the WFC Trust. In its capacity as a servicer, each of the respective banks earns a fee from the WFN Trusts and the WFC Trust to service and administer the credit card receivables, collect payments, and charge-off uncollectible receivables. These fees are eliminated and therefore are not reflected in the unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2013 and 2012.

The WFN Trusts and the WFC Trust are variable interest entities (“VIEs”), and the Company is deemed to be the primary beneficiary for the WFN Trusts and the WFC Trust, as it is the servicer for each of the trusts and is a holder of the residual interest. The Company, through its involvement in the activities of the trusts, has the power to direct the activities that most significantly impact the economic performance of the trust, and the obligation (or right) to absorb losses (or receive benefits) of the trust that could potentially be significant. The assets of these consolidated VIEs include certain credit card receivables that are restricted to settle the obligations of those entities and are not expected to be available to the Company or its creditors. The liabilities of the consolidated VIEs include non-recourse secured borrowings and other liabilities for which creditors or beneficial interest holders do not have recourse to the general credit of the Company.

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The tables below present quantitative information about the components of total securitized credit card receivables, delinquencies and net charge-offs:

	September 30, 2013	December 31, 2012
	(In thousands)	
Total credit card receivables – restricted for securitization investors	$ 6,185,497	$ 6,597,120
Principal amount of credit card receivables – restricted for securitization investors, 90 days or more past due	$ 120,210	$ 112,203

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
	(In thousands)			
Net charge-offs of securitized principal	$ 70,752	$ 61,441	$ 219,441	$ 184,886

4. REDEMPTION SETTLEMENT ASSETS

Redemption settlement assets consist of cash and cash equivalents and securities available-for-sale and are designated for settling redemptions by collectors of the AIR MILES® Reward Program in Canada under certain contractual relationships with sponsors of the AIR MILES Reward Program. These assets are primarily denominated in Canadian dollars. There were no realized gains or losses from the sale of investment securities for the three and nine months ended September 30, 2013 and 2012. The principal components of redemption settlement assets, which are carried at fair value, are as follows:

	September 30, 2013				December 31, 2012			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(In thousands)							
Cash and cash equivalents	$ 58,579	$ —	$ —	$ 58,579	$ 40,266	$ —	$ —	$ 40,266
Government bonds	—	—	—	—	5,064	53	—	5,117
Corporate bonds	480,761	7,504	(905)	487,360	436,846	10,560	(99)	447,307
Total	$ 539,340	$ 7,504	$ (905)	$ 545,939	$ 482,176	$ 10,613	$ (99)	$ 492,690

The following tables show the gross unrealized losses and fair value for those investments that were in an unrealized loss position as of September 30, 2013 and December 31, 2012, aggregated by investment category and the length of time that individual securities have been in a continuous loss position:

	September 30, 2013					
	Less than 12 months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
	(In thousands)					

Corporate bonds	$	98,868	$	(905)	$	—	$	—	$	98,868	$	(905)
Total	$	98,868	$	(905)	$	—	$	—	$	98,868	$	(905)

	December 31, 2012											
	Less than 12 months				12 Months or Greater				Total			
	Fair Value		Unrealized Losses		Fair Value		Unrealized Losses		Fair Value		Unrealized Losses	
	(In thousands)											
Corporate bonds	$	36,518	$	(99)	$	—	$	—	$	36,518	$	(99)
Total	$	36,518	$	(99)	$	—	$	—	$	36,518	$	(99)

Market values were determined for each individual security in the investment portfolio. When evaluating the investments for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis, the financial condition of the security's issuer, and the Company's intent to sell the security and whether it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. The Company typically invests in highly-rated securities with low probabilities of default and has the ability to hold the investments until maturity. As of September 30, 2013, the Company does not consider the investments to be other-than-temporarily impaired.

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The amortized cost and estimated fair value of the securities at September 30, 2013 by contractual maturity are as follows:

	Amortized Cost	Estimated Fair Value
	(In thousands)	
Due in one year or less	$ 141,764	$ 142,273
Due after one year through five years	397,576	403,666
Total	$ 539,340	$ 545,939

5. INTANGIBLE ASSETS AND GOODWILL

Intangible Assets

Intangible assets consist of the following:

	September 30, 2013			
	Gross Assets	Accumulated Amortization	Net	Amortization Life and Method
		(In thousands)		
Finite Lived Assets				
Customer contracts and lists	$ 440,200	$ (171,600)	$ 268,600	3-12 years—straight line
Premium on purchased credit card portfolios	214,337	(109,837)	104,500	5-10 years—straight line, accelerated
Customer database	161,700	(117,349)	44,351	4-10 years—straight line
Collector database	67,899	(62,335)	5,564	30 years—15% declining balance
Tradenames	58,555	(13,992)	44,563	4-15 years—straight line
Purchased data lists	16,834	(11,099)	5,735	1-5 years—straight line, accelerated
Favorable lease	3,291	(289)	3,002	10 years—straight line
Noncompete agreements	1,300	(325)	975	3 years—straight line
	$ 964,116	$ (486,826)	$ 477,290	
Indefinite Lived Assets				
Tradenames	12,350	—	12,350	Indefinite life
Total intangible assets	$ 976,466	$ (486,826)	$ 489,640	

	December 31, 2012			
	Gross Assets	Accumulated Amortization	Net	Amortization Life and Method
		(In thousands)		
Finite Lived Assets				
Customer contracts and lists	$ 440,200	$ (124,351)	$ 315,849	3-12 years—straight line
	237,800	(108,227)	129,573	

Premium on purchased credit card portfolios							5-10 years—straight line, accelerated
Customer database		161,700		(102,706)		58,994	4-10 years—straight line
Collector database		70,550		(63,980)		6,570	30 years—15% declining balance
Tradenames		59,102		(10,139)		48,963	4-15 years—straight line
Purchased data lists		14,540		(8,527)		6,013	1-5 years—straight line, accelerated
Favorable lease		3,291		(29)		3,262	10 years—straight line
Noncompete agreements		1,300		—		1,300	3 years—straight line
	$	988,483	$	(417,959)	$	570,524	
Indefinite Lived Assets							
Tradenames		12,350		—		12,350	Indefinite life
Total intangible assets	$	1,000,833	$	(417,959)	$	582,874	

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ALLIANCE DATA SYSTEMS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (CONTINUED)

Goodwill

The changes in the carrying amount of goodwill for the nine months ended September 30, 2013 are as follows:

	LoyaltyOne®	Epsilon®	Private Label Services and Credit	Corporate/ Other	Total
			(In thousands)		
December 31, 2012	$ 248,070	$ 1,241,251	$ 261,732	$ —	$ 1,751,053
Effects of foreign currency translation	(8,898)	(176)	—	—	(9,074)
September 30, 2013	$ 239,172	$ 1,241,075	$ 261,732	$ —	$ 1,741,979

6. DEBT

Debt consists of the following:

Description	September 30, 2013	December 31, 2012	Maturity	Interest Rate
	(Dollars in thousands)			
Long-term and other debt:				
2013 credit facility	$ 269,000	$ —	July 2018	(1)
2013 term loan	1,192,500	—	July 2018	(1)
2011 term loan	—	885,928	—	—
Convertible senior notes due 2013	—	768,831	—	—
Convertible senior notes due 2014	325,499	304,333	May 2014	4.75%
Senior notes due 2017	396,313	395,734	December 2017	5.250%
Senior notes due 2020	500,000	500,000	April 2020	6.375%
Capital lease obligations and other debt	—	13	—	—
Total long-term and other debt	2,683,312	2,854,839		
Less: current portion	(355,499)	(803,269)		
Long-term portion	$ 2,327,813	$ 2,051,570		
Deposits:				
Certificates of deposit	$ 2,050,504	$ 1,974,158	Various – October 2013 – May 2020	0.15% to 5.25%
Money market deposits	260,003	254,253	On demand	0.01% to 0.18%
Total deposits	2,310,507	2,228,411		
Less: current portion	(1,138,905)	(1,092,753)		
Long-term portion	$ 1,171,602	$ 1,135,658		

Non-recourse borrowings of consolidated securitization entities:						
Fixed rate asset-backed term note securities	$	3,001,916	$	2,403,555	Various – October 2014 – June 2019	0.91% to 6.75%
Floating rate asset-backed term note securities		—		545,700	—	—
Conduit asset-backed securities		980,000		1,181,715	Various – March 2014 – September 2015	1.18% to 1.71%
Total non-recourse borrowings of consolidated securitization entities		3,981,916		4,130,970		
Less: current portion		(315,000)		(1,474,054)		
Long-term portion	$	3,666,916	$	2,656,916		

(1) At September 30, 2013, the weighted average interest rate was 2.18% for both the 2013 Credit Facility and 2013 Term Loan.

At September 30, 2013, the Company was in compliance with its covenants.

Credit Agreements

In July 2013, the Company, as borrower, and ADS Alliance Data Systems, Inc., ADS Foreign Holdings, Inc., Alliance Data Foreign Holdings, Inc., Epsilon Data Management, LLC, Comenity LLC, Comenity Servicing LLC and Aspen Marketing Services, LLC, as guarantors, entered into a credit agreement with various agents and lenders dated July 10, 2013 (the “2013 Credit Agreement”), replacing the Company’s credit agreement dated May 24, 2011 (the “2011 Credit Agreement”). The 2011 Credit Agreement provided for a $903.1 million term loan subject to certain principal repayments and a $917.5 million revolving line of credit. Upon entering into the 2013 Credit Agreement, the 2011 Credit Agreement was terminated.

Wells Fargo Bank, N.A. is the administrative agent and letter of credit issuer under the 2013 Credit Agreement. The 2013 Credit Agreement provides for a $1,142.5 million term loan (the "2013 Term Loan") with certain principal repayments and a $1,142.5 million revolving line of credit (the "2013 Credit Facility") with a U.S. $65.0 million sublimit for Canadian dollar borrowings and a $65.0 million sublimit for swing line loans. The 2013 Credit Agreement includes an uncommitted accordion feature of up to $500.0 million (in certain circumstances, up to $615.0 million) in the aggregate allowing for future incremental borrowings, subject to certain conditions.

In September 2013, the Company exercised in part the accordion feature of the 2013 Credit Agreement, and increased the borrowings under the 2013 Term Loan by $57.5 million to $1.2 billion and increased the capacity under the 2013 Credit Facility by $57.5 million to $1.2 billion.

Total availability under the 2013 Credit Facility at September 30, 2013 was $931.0 million.

In October 2013, the Company exercised in part the accordion feature of the 2013 Credit Agreement, and increased the borrowings under the 2013 Term Loan and the capacity under the 2013 Credit Facility, each by $25.0 million.

The loans under the 2013 Credit Agreement are scheduled to mature on July 10, 2018. The 2013 Term Loan provides for aggregate principal payments of 2.5% of the initial term loan amount in each of the first and second year and 5% of the initial term loan amount in each of the third, fourth, and fifth year, payable in equal quarterly installments beginning on September 30, 2013. The 2013 Credit Agreement is unsecured.

Advances under the 2013 Credit Agreement are in the form of either U.S. dollar-denominated or Canadian dollar-denominated base rate loans or U.S. dollar-denominated eurodollar loans. The interest rate for base rate loans denominated in U.S. dollars fluctuates and is equal to the highest of (i) Wells Fargo's prime rate (ii) the Federal funds rate plus 0.5% and (iii) the London Interbank Offered Rate ("LIBOR") as defined in the 2013 Credit Agreement plus 1.0%, in each case plus a margin of 0.25% to 1.0% based upon the Company's total leverage ratio as defined in the 2013 Credit Agreement. The interest rate for base rate loans denominated in Canadian dollars fluctuates and is equal to the higher of (i) Wells Fargo's prime rate for Canadian dollar loans and (ii) the Canadian Dollar Offered Rate ("CDOR") plus 1.0%, in each case plus a margin of 0.25% to 1.0% based upon the Company's total leverage ratio as defined in the 2013 Credit Agreement. The interest rate for eurodollar loans fluctuates based on the rate at which deposits of U.S. dollars in the London interbank market are quoted plus a margin of 1.25% to 2.0% based on the Company's total leverage ratio as defined in the 2013 Credit Agreement.

The 2013 Credit Agreement contains the usual and customary negative covenants for transactions of this type, including, but not limited to, restrictions on the Company's ability and in certain instances, its subsidiaries' ability to consolidate or merge; substantially change the nature of its business; sell, lease, or otherwise transfer any substantial part of its assets; create or incur indebtedness; create liens; pay dividends; and make acquisitions. The negative covenants are subject to certain exceptions as specified in the 2013 Credit Agreement. The 2013 Credit Agreement also requires the Company to satisfy certain financial covenants, including a maximum total leverage ratio as determined in accordance with the 2013 Credit Agreement and a minimum ratio of consolidated operating EBITDA to consolidated interest expense as determined in accordance with the 2013 Credit Agreement. The 2013 Credit Agreement also includes customary events of default.

Convertible Senior Notes

At September 30, 2013, the Company had outstanding $345.0 million of convertible senior notes scheduled to mature on May 15, 2014 (the "Convertible Senior Notes due 2014"). On August 1, 2013, the Company settled in cash the remaining $772.6 million of convertible senior notes due August 1, 2013, of which $772.5 million was surrendered for conversion for $1,790.3 million, with the remaining principal paid at maturity. The Company received $1,017.7 million of cash from the counterparties in settlement of the related convertible note hedge transactions.

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The table below summarizes the carrying value of the components of the convertible senior notes:

	September 30, 2013	December 31, 2012
	(In millions)	
Carrying amount of equity component	$ 115.9	$ 368.7
Principal amount of liability component	$ 345.0	$ 1,150.0
Unamortized discount	(19.5)	(76.8)
Net carrying value of liability component	$ 325.5	$ 1,073.2
If-converted value of common stock	$ 1,533.7	$ 2,534.4

The discount on the liability component will be amortized as interest expense over the remaining life of the Convertible Senior Notes due 2014 which, at September 30, 2013, is a period of 0.6 years.

Interest expense on the convertible senior notes recognized in the Company's unaudited condensed consolidated statements of income for the three and nine months ended September 30, 2013 and 2012 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands, except percentages)			
Interest expense calculated on contractual interest rate	$ 5,074	$ 7,619	$ 20,073	$ 22,856
Amortization of discount on liability component	12,602	20,865	57,321	60,915
Total interest expense on convertible senior notes	$ 17,676	$ 28,484	$ 77,394	$ 83,771
Effective interest rate (annualized)	13.2%	11.0%	11.8%	11.0%

The Convertible Senior Notes due 2014 are convertible at the option of the holder based on the condition that the common stock trading price exceeded 130% of the applicable conversion price. Through September 30, 2013, a de minimis amount of the Convertible Senior Notes due 2014 were surrendered for conversion and, in each case, either have been or will be settled in cash following the completion of the applicable cash settlement averaging period.

Senior Notes Due 2017

In November 2012, the Company issued and sold $400 million aggregate principal amount of 5.250% senior notes due December 1, 2017 (the "Senior Notes due 2017") at an issue price of 98.912% of the aggregate principal amount. The unamortized discount was $3.7 million and $4.3 million at September 30, 2013 and December 31, 2012, respectively. The discount is being amortized using the effective interest method over the remaining life of the Senior Notes due 2017 which, at September 30, 2013, is a period of 4.2 years at an effective annual interest rate of 5.5%.

Deposits

As of September 30, 2013, Comenity Bank and Comenity Capital Bank had issued $260.0 million in money market deposits. Money market deposits are redeemable on demand by the customer and, as such, have no scheduled maturity date.

Non-Recourse Borrowings of Consolidated Securitization Entities

Asset-Backed Term Notes

In February 2013, Master Trust I issued $500.0 million of asset-backed term securities to investors, which will mature in February 2018. The offering consisted of $375.0 million of Class A Series 2013-A asset-backed notes with a fixed interest rate of 1.61% per year and an aggregate of $125.0 million of subordinated classes of the asset-backed term notes that were retained by the Company and are eliminated from the unaudited condensed consolidated financial statements.

In April 2013, $500.0 million of floating rate Series 2006-A asset-backed term notes matured and were repaid by the Company.

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ALLIANCE DATA SYSTEMS CORPORATION
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In May 2013, Master Trust I issued $657.9 million of asset-backed term securities to investors, which will mature in May 2016. The offering consisted of $500.0 million of Class A Series 2013-B asset-backed notes with a fixed interest rate of 0.91% per year and an aggregate of $157.9 million of subordinated classes of the asset-backed term notes that were retained by the Company and are eliminated from the unaudited condensed consolidated financial statements.

In July 2013, $245.0 million of fixed rate Series 2009-D asset-backed term notes matured and were repaid by the Company.

Conduit Facilities

The Company has access to committed undrawn capacity through three conduit facilities to support the funding of its credit card receivables through Master Trust I, Master Trust III and the WFC Trust. As of September 30, 2013, total capacity under the conduit facilities was $2.1 billion, of which $980.0 million had been drawn and was included in non-recourse borrowings of consolidated securitization entities in the unaudited condensed consolidated balance sheet. Borrowings outstanding under each facility bear interest at a margin above LIBOR or the asset-backed commercial paper costs of each individual conduit provider. The conduits have varying maturities from March 2014 to September 2015 with variable interest rates ranging from 1.18% to 1.71% as of September 30, 2013.

In May 2013, the Company renewed its 2009-VFN conduit facility under World Financial Capital Master Note Trust, extending the maturity to May 31, 2015 and increasing the total capacity from $375.0 million to $450.0 million.

In September 2013, the Company renewed its 2009-VFC1 conduit facility under World Financial Network Credit Card Master Note Trust III, extending the maturity to September 24, 2015 and increasing the total capacity from $330.0 million to $440.0 million.

Derivative Instruments

As part of its interest rate risk management program, the Company may enter into derivative contracts with institutions that are established dealers to manage its exposure to changes in interest rates for certain obligations.

The credit card securitization trusts entered into certain interest rate derivative instruments that involved the receipt of variable rate amounts from counterparties in exchange for the Company making fixed rate payments over the life of the agreement without the exchange of the underlying notional amount. These interest rate derivative instruments were not designated as hedges. Such instruments were not speculative and were used to manage interest rate risk, but did not meet the specific hedge accounting requirements of ASC 815, “Derivatives and Hedging.”

The Company’s outstanding interest rate derivative instruments matured in April 2013. The Company was not a party to any derivative instruments as of September 30, 2013.

There were no gains on derivative instruments for the three months ended September 30, 2013. Gains on derivative instruments of $7.5 million for the three months ended
September 30, 2012, and $8.5 million and $22.7 million for the nine months ended September 30, 2013 and 2012, respectively, were recognized in securitization funding costs within the unaudited condensed consolidated statements of income.

The following tables identify the notional amount, fair value and classification of the Company’s outstanding interest rate derivatives at December 31, 2012 in the unaudited condensed consolidated balance sheets:

	December 31, 2012		
	Notional Amount		Weighted Average Years to Maturity
	(Dollars in thousands)		
Interest rate derivatives not designated as hedging instruments	$	545,700	0.51

	December 31, 2012		
	Balance Sheet Location		Fair Value
	(In thousands)		
Interest rate derivatives not designated as hedging instruments	Other assets	$	4
Interest rate derivatives not designated as hedging instruments	Other current liabilities		