



## LIMITED PURPOSE

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Comptroller of the Currency  
Administrator of National Banks

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### Public Disclosure

March 2, 2004

## Community Reinvestment Act Performance Evaluation

Direct Merchants Credit Card Bank, NA  
Charter Number: 22734

16430 North Scottsdale Road  
Phoenix, Arizona 85254

Office of the Comptroller of the Currency  
Special Supervision  
250 E Street, SW  
Washington, D.C. 20219

**NOTE:** This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

## **Institution's CRA rating:**

**This institution is rated "Satisfactory".**

The conclusions for the three rating criteria are:

- The bank demonstrates an adequate level of community development services, and qualified investments.
- The bank demonstrates rare use of innovative or complex community development services.
- The bank demonstrates adequate responsiveness to credit and community development needs in its assessment area.

## **Scope of the Examination**

In evaluating the bank's performance under the CRA, we reviewed community development activities from **March 6, 2000** through **March 2, 2004**. We reviewed the level and nature of qualified investments and community development services. At the bank's request, we also considered qualified investments provided by its affiliates. At the prior examination dated **March 6, 2000**, we rated the bank "Satisfactory".

DMCCB has adequately addressed the needs of its assessment area, and therefore, community development investments and services outside of the assessment area were considered in evaluating its performance.

## **Description of Institution**

Phoenix-based, Direct Merchants Credit Card Bank, N.A. (DMCCB) is 100% owned by Metris Direct, Inc., a wholly owned subsidiary of Metris Companies, Inc. (Metris). Both affiliates are located in Minnetonka, Minnesota. Besides Minnetonka, Metris conducts operations relating to credit cards and related services in Phoenix, Arizona; Tulsa, Oklahoma; White Marsh, Maryland; Jacksonville, Florida; Orlando, Florida; and Duluth, Minnesota.

DMCCB was granted a charter in February 1995, as a Competitive Equality Banking Act (CEBA) credit card bank located in Salt Lake City, Utah. Designation as a limited-purpose institution for the purpose of the Community Reinvestment Act occurred March 19, 1996. DMCCB relocated to Scottsdale in 1998 and then most recently to adjacent Phoenix, Arizona, in October 2003. DMCCB has no branches and issues both MasterCard and Visa credit cards (a significant portion to borrowers with subprime characteristics) since CEBA status limits the bank's lending to issuance of consumer credit cards. With the exception of a small, secured card portfolio (\$6.3 million), no savings or time deposits currently exist.

DMCCB has approximately seven employees, with the majority of functions outsourced to its affiliates. Employment for all related entities totals approximately 2,896 at year-end 2003.

DMCCB sells its credit card receivables to Metris on a daily basis, without recourse, with DMCCB retaining ownership and servicing rights of each account. Metris securitizes the credit card receivables through a master trust for funding purposes. Metris' tenuous financial condition combined with regulatory actions placed upon DMCCB have adversely impacted if not prohibited the bank's community development investment plans. Consequently investments were curtailed and more emphasis placed on community development services within the assessment area.

The following table shows financial information for DMCCB for the years ending 2000, 2001, 2002, and 2003.

**Table 1: Financial Information (000s)**

	<b>Year-end 2000</b>	<b>Year-end 2001</b>	<b>Year-end 2002</b>	<b>Year-end 2003</b>	<b>Average for Evaluation Period</b>
<b>Tier 1 Capital</b>	199,883	308,186	385,658	238,229	282,989
<b>Total Income</b>	714,453	1,086,204	807,299	534,625	785,645
<b>Net Operating Income</b>	54,690	35,245	77,472	46,445	53,463
<b>Total Assets</b>	2,440,723	2,919,547	1,417,774	326,540	1,776,146
<b>Pass-Through Receivables</b>	9,273,108	11,906,153	10,476,735	8,859,666	10,128,916

Source: Consolidated Report of Condition and Income and bank reported data.

While the financial information for DMCCB appears favorable, when consolidated with the Metris, results were not as favorable. Metris operations resulted in several consecutive quarters of net operating losses that adversely impacted capital, liquidity and Metris' ability to fund DMCCB on an ongoing basis. Additionally, higher capital levels are required, per subprime lending guidelines published by the regulatory agencies.

## **Description of Assessment Area**

DMCCB operates in the urban area of Phoenix, Arizona, which is part of the Phoenix-Mesa Metropolitan Statistical Area (Phoenix-Mesa MSA). This MSA is the designated assessment area (AA) of the bank and meets legal requirements of the CRA. The AA entails all of Maricopa County and portions of Pinal County along the AA's southern boundry. This AA includes 696 census tracks. The following table reflects the demographics of the bank's AA.

Maricopa County is one of the largest counties in the country with approximating 9,222 square miles of surface area, nearing the size of Vermont. The county is also one of the fastest growing counties in the United States, with a decade of population growth of more than 1 million between

1990 and 2000. The AA population estimate for 2003, totals 3.3 million, which equates to 60% of the state's population. Major cities in the AA include Phoenix, Mesa, Scottsdale, Tempe, Chandler, Gilbert, Glendale, Peoria, and Goodyear. In addition to the above cities, there are large unincorporated areas in the county and several Native American reservations. The following table below shows the demographics of the bank's assessment area.

**Table 2: Assessment Area Description**

	<b>Number</b>	<b>Low</b>	<b>Moderate</b>	<b>Middle</b>	<b>Upper</b>
<b>Tracts</b>	696	6%	29%	34%	30%
<b>Families</b>	814,264	19%*	19%*	22%*	40%*
<b>Businesses</b>	182,164	6%**	27%**	32%**	35%**

Source: Demographic Data - 2000 U.S. Census, Dun & Bradstreet Data.

\*Represents families by income level.

\*\*Represents businesses by income level of census tract. *Note: Percentages do not add to 100%, due to rounding.*

Information obtained from community groups indicates that although there is significant competition for the larger investments, there are numerous opportunities for banks in this AA. These investment opportunities include the need for loans to small businesses in the form of micro loans ranging from \$2,000-\$35,000 and up to \$250,000. Other opportunities include investments in affordable housing initiatives for low- and moderate-income individuals and families. This need has become more critical due to a booming real estate market that has increased housing prices. Affordable rental housing is also needed in the AA. Additionally there are many services offered through CD organizations needing funding and technical assistance, including financial education assistance to LMI individuals, families and first time homebuyers.

Maricopa County's main economic sectors include services, trade, and manufacturing. These sectors include thriving industries in tourism, high tech, biomedical, transportation, and commercial and residential construction. The 2003, updated median family income is \$58,300. Unemployment rate for YE 2003 was 5.0%, down from 5.7% in 2002. The median housing price has nearly doubled since the 1990 census and approximates \$160,000, which puts home ownership out of reach by most LMI families in the AA.

Numerous competing financial institutions are represented in the assessment area, including large nationwide banking companies such as Wells Fargo Bank, N.A., JP Morgan Chase/Bank One, N.A., Bank of America, N.A., Washington Mutual Bank, M & I Bank, and Compass Bank, and numerous other community banks and credit unions. All these financial institutions are vying for opportunities to meet community development needs and have far greater financial and human resources than DMCCB. This is especially true during the past two years as DMCCB and Metris have faced significant adversity from operating losses, liquidity concerns and the ability to sustain ongoing operations.

DMCCB's designation as a CEBA bank poses a major barrier to meeting the most pressing community development needs in the lending arena. CEBA banks are prohibited from making small business and mortgage loans and may only issue credit cards. However, opportunities do exist for community development grants and services that target small business and home

ownership groups or entities. The CEBA bank may also invest in deposits placed with community based credit unions or CDFIs.

## **Conclusions About Performance**

### **Summary**

Overall, DMCCB demonstrated adequate performance in helping meet community development needs of the assessment area through investments that facilitate home ownership for LMI individuals and families. CD services involve bank employees delivering financial education and expertise to groups that serve LMI individuals and families.

- The level of community development investments and services is adequate, considering the opportunities available for limited purpose banks, the bank's small staff and diminished financial capacity during the evaluation period. While competition is keen among financial services within the AA, there remain ample opportunities for CD investments and services.
- While CD investments are not innovative or complex, one of the CD services reflect creativity and originality. The bank partnered with a non-profit that provides a structured leadership-training program, which includes a paid internship at the bank for LMI minority students.
- The bank's responsiveness to community development needs in the AA is adequate. A majority of the bank's current period qualified investments, \$2.1 million helped provide the critical need for affordable housing within the AA through the purchase of low-income housing bonds. Prior period investments remaining outstanding include similar bonds totaling \$280 thousand. Of the prior period bonds outstanding, an additional \$1 million were redeemed early during the evaluation period. The bank also has a \$50M CD with a local CDFI that provides banking and lending services to predominately LMI individuals and families. Affiliate activities, including a broader area outside of the AA, have also provided grants to many non-profit organizations serving LMI individuals. Also during the evaluation period, management and staff offered CD services in a financial capacity to organizations that service LMI individuals and families.

### **Qualified Investments**

During the review period, DMCCB provided \$2.8 million in investments and grants to community development organizations. About \$2.2 million benefited the AA and \$594 thousand benefited areas outside the bank's AA. Prior period investments of \$330 thousand within the AA and \$140 thousand outside the AA remained outstanding. Additionally the bank's board had allocated an additional \$2 million for investments at year-end 2001. However, during the following year, Metris' well-publicized financial difficulties came to light and the board elected

to cancel the funding of investments as a prudent decision, since safety and soundness concerns became the higher priority.

**Table 3a: Qualified Investment Activity (000s)**

	<b>Benefits AA</b>	<b>Outside AA</b>	<b>Totals</b>
<b>Originated Investments</b>	\$2,000	None	\$2,000
<b>Originated Grants</b>	\$249	\$594	\$843
<b>Prior-Period Investments that Remain Outstanding</b>	\$330	\$140	\$470
<b>Total Qualified Investments</b>	\$2,579	\$734	\$3,313

**Table 4a: Qualified Investment Percentages**

	<b>Benefits AA (%)</b>	<b>Outside AA (%)</b>	<b>Total (%)</b>
<b>Total Investments/Average Tier 1 Capital</b>	0.91%	.259%	1.17%
<b>Total Investments/Average Total Income</b>	0.032%	0.09%	0.42%
<b>Total Investments/Average Pass-Through Receivables</b>	0.025%	0.007%	0.032%

The above investment amounts expressed as percentage of Average Tier 1 Capital, in Table 4a, reflect the bank's requirement to maintain a higher level of capital in accord with the FFIEC Expanded Guidance for Subprime Lending Programs. Under conventional guidance for well-capitalized banks, investments that benefit the AA would equal 1.60% of Tier 1 capital and investments outside the AA would equal .45%. The total would equal 2.05%.

DMCCB's most notable qualified investments/grants in the AA consist of the following:

- \$2 million investment in Maricopa County Housing Bonds, which support multifamily housing for low-and moderate-income individuals and families.
- \$50 thousand certificate of deposit with a local CDFI credit union, which predominately serves the community development needs of the Hispanic community through small business, economic development, and mortgage lending. This CDFI also offers LMI families and individuals small loans of all types to LMI persons in the AA.
- \$77 thousand in grants to eleven different non-profit organizations that provide

emergency housing and various types of homebuyer assistance and education to LMI individuals and families.

- \$172 thousand in grants to various community development organizations that provide essential services and support, with the goal of assisting LMI individuals and families in achieving economic self-sufficiency.

The investments and grants outside of the bank's AA are also considered toward the bank's overall community development effort as follows:

- \$594 thousand in grants to various community development organizations that provide essential services and support, with the goal of assisting LMI individuals and families in achieving economic self-sufficiency.
- \$140 thousand prior period investment in housing bonds, which support multifamily housing for low-and moderate-income individuals and families in the bank's previous assessment area in Utah.

### Community Development Services

Due to the parent company's problematical financial condition, the board and management decided to focus more attention upon community development services rather than investments during this evaluation period.

**Table 5: Community Development Service Activities**

CD Service	Benefits AA	Outside AA
Provides financial education and expertise to a nationwide organization serving the Hispanic community.	X	X
Participates in regional volunteer training program related to money and credit management targeting LMI families or individuals.	X	
Sponsors and supports financial educational and internship programs for LMI minority students.	X	

X means "yes"; blank means "no".

The following information provides more detail about the bank's community development services in the same order listed in the above table:

- Bank officers have made financial presentations and one serves in a financial capacity on the national Board of Directors of the League of United Latin American Citizens. One presentation regarding credit principles was conducted at the National Convention. A large percentage of the constituency are LMI individuals. Another presentation was

conducted in Tucson, Arizona at a Youth Leadership Conference to predominately LMI high school and middle school students. Topics covered sound financial management principles for achieving success.

- Several bank employees were certified by Consumer Credit Counseling Services to participate in the Southwest Certified Money Management Volunteer Program. Certification involves a four-hour class, which prepares volunteer instructors to teach a one-hour session about fundamental principles of money and credit management. Employees have taught the class 20 times during the evaluation period to various groups comprised of LMI individuals and families including homeless shelters, battered women's shelters, the Phoenix Urban League and Neighborhood Outreach Programs.
- DMCCB partners with INROADS, Inc which mentors and places minority students, a majority of which are LMI, into two- to five-year internships with participating organizations. This service includes financial education and paid on-the-job practical experience and training. DMCCB hosts one student each summer. In addition, a bank officer facilitated a three-hour class for finance students participating in INROADS at Arizona State University. The former bank president and a director both served on the INROADS, Inc. Board of Directors in a financial capacity.

### **Fair Lending Review**

We found no evidence of illegal discrimination or other illegal credit practices.

## Definitions and Common Abbreviations

The following terms and abbreviations are used throughout this performance evaluation. The definitions are intended to provide the reader with a general understanding of the terms, not a strict legal definition.

**Affiliate** – Any company that controls, is controlled by, or is under common control with another company. A company is under common control with another company if both companies are directly or indirectly controlled by the same company. A bank subsidiary is controlled by the bank and is, therefore, an affiliate.

**Assessment Area (AA)** – A geographic area that consists generally of one or more MSAs (using the MSA boundaries that were in effect as of January 1 of the calendar year in which the delineation is made) or one or more contiguous political subdivisions, such as counties, cities, or towns, in which the bank has its main office, branches, and deposit-taking ATMs.

**Benefit to Assessment Area** – A qualified Community Development activity benefits the assessment area if (i) the activity benefits areas within the assessment area, or (ii) the activity benefits a broader statewide or regional area that includes the bank's assessment area. If a bank has adequately addressed the needs of its assessment area, then the OCC also considers activities submitted by the bank that benefit areas outside of its assessment area.

**Block Numbering Area (BNA)** – Statistical subdivisions of counties in which census tracts have not been established. The United States Census Bureau has established BNAs in conjunction with state agencies.

**CEBA** – Competitive Equality Banking Act of 1987, which permitted corporations to form limited-purpose credit card banks, whose operations are restricted to credit card activities, without the corporation becoming subject to the limitations of a "bank holding company" under the Bank Holding Company Act. A CEBA credit card bank engages only in credit card operations, does not accept demand deposits or savings or time deposits of less than \$100,000 (other than to secure extensions of credit), maintains only one office and does not engage in the business of making commercial loans.

**Census Tract (CT)** – Small, locally defined statistical areas within metropolitan statistical areas. These areas are determined by the United States Census Bureau in an attempt to group homogenous populations. A CT has defined boundaries per 10-year census and an average population of 4,000.

**Community Development (CD)** – Affordable housing for low- or moderate-income individuals; community services targeted to low- or moderate-income individuals; activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of \$1 million or less; or activities that revitalize or stabilize low- or moderate-income geographies.

**Community Reinvestment Act (CRA)** – The statute that requires the OCC to evaluate a bank's record of meeting the credit needs of its local community, consistent with the safe and sound operation of the bank, and to take this record into account when evaluating certain corporate applications filed by the bank.

**Geography** – A census tract or a block numbering area delineated by the United States Bureau of the Census in the most recent decennial census.

**Limited Purpose Institution** – An institution that offers only a narrow product line (such as credit cards or automobile loans) to a regional or broader market and for which a designation as limited purpose bank is in effect.

**Median Family Income (MFI)** – The median income determined by the United States Census Bureau every 10 years and used to determine the income level category of geographies. Also, it is the median income determined by the Department of Housing and Urban Development annually that is used to determine the income level category of families. For any given geography, the median is the point at which half of the families have income above it and half below it. (See the four categories of median income below.)

- **Low-Income** – An income level that is less than 50% of the MFI.
- **Moderate-Income** – An income level that is at least 50% and less than 80% of the MFI.
- **Middle-Income** – An income level that is at least 80% and less than 120% of the MFI.
- **Upper-Income** – An income level that is 120% or more of the MFI.

**Metropolitan Statistical Area (MSA)** – Area defined by the director of the United States Office of Management and Budget. MSAs consist of one or more counties, including large population centers and nearby communities that have a high degree of interaction.

**Net Operating Income** – As listed in the Consolidated Report of Condition and Income: Income before income taxes and extraordinary items and other adjustments. [*Schedule RI - Income Statement, line 8 or UBPR, page 2, "PreTax Operating Income (TE)"*]

**Pass-Through Receivables** – Outstanding receivables tied to all accounts issued or owned by the bank. Pass-through receivables include receivables attributable to and receivables retained on balance sheet as those terms are used in 12 C.F.R. § 8.

**Tier 1 Capital** – The total of common shareholders' equity, perpetual preferred shareholders' equity with noncumulative dividends, retained earnings and minority interests in the equity accounts of consolidated subsidiaries.

**Subprime Lending** - The term "subprime" refers to credit characteristics of individual borrowers. These characteristics reflect weakened credit histories that include payment delinquencies, and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit

histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at time of origination or purchase. Such loans have a higher risk of default than loans to prime borrowers. See *OCC Bulletin 2001-6, Subprime Lending, dated January 31, 2001* for more detail.

**Total Assets** – Total bank assets as listed in the Consolidated Report of Condition and Income.

**Total Income** – From the Consolidated Report of Condition and Income – total interest income plus total noninterest income.