

Washington, DC 20219

Public Disclosure

March 6, 2000

Community Reinvestment Act Performance Evaluation

**Direct Merchants Credit Card Bank, N.A.
Charter Number: 22734**

**17600 Perimeter Drive
Scottsdale, Arizona 85255**

**Office of the Comptroller of the Currency
Western District Office
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NOTE: 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.

General Information

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the 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. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

This document is an evaluation of the CRA performance of **Direct Merchants Credit Card Bank, N.A.** prepared by the **Office of the Comptroller of the Currency**, the institution's supervisory agency, as of **March 6, 2000**. The agency evaluates performance in assessment area(s), as they are delineated by the institution, rather than individual branches. This assessment area evaluation may include the visits to some, but not necessarily all of the institution's branches. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 25.

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 by 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 which 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, (ii) the activity benefits a broader statewide or regional area that includes the bank's assessment area, or (iii) the supervisory office may give positive consideration to CD activities outside the AA as benefiting the 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 bank being considered a bank 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 \$100M (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 areas. These areas are determined by the United States Census Bureau in an attempt to group homogenous populations. A CT has defined boundaries per ten 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 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. A limited-purpose institution continues to meet the narrow product line requirement if it only infrequently provides other types of loans.

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

Low-Income Family or Geography - An income level that is less than 50% of the MFI.

Moderate-Income Family or Geography - An income level that is at least 50% and less than 80% of the MFI.

Middle-Income Family or Geography - An income level that is at least 80% and less than 120% of the MFI.

Upper-Income Family or Geography - 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 defined by the Consolidated Report of Condition and Income, income before adjusting for extraordinary items.

Pass Through Receivables - Outstanding receivables tied to all accounts issued or owned by the bank. The bank provides this information.

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.

Total Assets - Total bank assets as defined by the Consolidated Report of Condition and Income.

Total Income - From the Consolidated Report of Condition and Income -- Interest income plus noninterest income.

Scope of the Examination

In evaluating the bank's performance under the CRA, we reviewed community development activities from January 1, 1998, through February 29, 2000. We reviewed the level and nature of qualified community development investments and services. We also considered investments provided on behalf of the bank by its parent company, Metris Companies, Inc. At the prior examination dated December 31, 1997, we rated the bank "Satisfactory".

Institution's CRA rating

This institution is rated "Satisfactory".

The major characteristics that support this rating are:

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

Description of Institution

Direct Merchants Credit Card Bank, N.A. (DMCCB) is headquartered in Scottsdale, Arizona. The bank has no branches. DMCCB was originally chartered in Salt Lake City, Utah, in February 1995, as a Competitive Equality Banking Act (CEBA) credit card bank, and received its designation as a limited-purpose institution for the purposes of the Community Reinvestment Act in 1996. In July 1998, DMCCB relocated to Scottsdale. The bank has almost 400 employees. DMCCB issues MasterCard and Visa credit cards. The CEBA status limits the bank's ability to extend loans outside the scope of consumer credit cards and accept savings or time deposits of less than \$100,000. For year-end 1999, the bank reported total on-book assets of \$1.03 billion and total revenue of \$422 million. DMCCB's assets reflect the bank's practice of selling the majority of its credit card receivables to its parent company, Metris Companies, Inc. (Metris), on a daily basis, without recourse. The bank retains account ownership. Metris securitizes credit card receivables through a master trust securitization vehicle for funding purposes.

DMCCB is 100% owned by Metris, which is headquartered in St. Louis Park, Minnesota. Metris is an information-based direct marketer of consumer credit products, fee-based services, and extended service plans, primarily to moderate-income consumers. In addition to the operation in Scottsdale,

Metris also has operations in Tulsa, Oklahoma; Baltimore, Maryland; and Champaign, Illinois. It employs about 3,100 people. In September 1999, the company ranked as the 11th largest issuer of credit cards in the United States. As of December 31, 1999, Metris reported \$2 billion in on-book assets and \$191 million in annual revenues.

The following table shows financial information for DMCCB for the years ending 1997, 1998, and 1999.

Table 1: Financial Information (000s)

	*Year-end 1997	*Year-end 1998	*Year-end 1999	Average for Evaluation Period
Tier 1 Capital	13,942	16,745	127,890	52,859
Total Income	134,122	203,639	421,798	253,186
Net Operating Income	25,331	40,852	57,822	41,335
Total Assets	69,750	66,477	1,030,790	389,006
Pass Through Receivables	3,546,936	5,315,042	6,250,532	5,037,503

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

* Actual data reported.

Description of Assessment Area

DMCCB operates in an urban area. The bank has designated Maricopa County as its assessment area. It consists of 466 census tracts. The assessment area meets the legal requirements of the CRA. The table below shows the demographics of the bank's assessment area.

Table 2: Assessment Area Description

	Number	Low	Moderate	Middle	Upper
Tract*	466	6%	23%	38%	32%
Families	552,909	19%	18%	23%	40%
Small Business*	66,021	5%	22%	36%	36%

Source: Demographic Data - 1990 U.S. Census, Dun & Bradstreet Data

*1% of the tracts do not have an income designation.

Maricopa County is one of the largest counties in the country stretching 100 miles in diameter and covering a total of 9200 square miles. As of December 1999, the population was estimated to be 2.8 million. The county is comprised of the city of Phoenix and several small cities such as Avondale, Buckeye, Chandler, Goodyear, Glendale, Mesa, Scottsdale, Tempe, Gilbert, and Wickenburg. In

addition to the urban cities in the county, there is a large unincorporated area and several Indian reservations.

The area is in the midst of an economic growth period supported by thriving high tech, tourism, biomedical, and transportation industries. The 1999 HUD updated median family income is \$50,200. As of January 2000, the county's unemployment rate was at 2.8%. The 1990 census data indicates a median housing price of \$87,219. However, various non-profit organizations indicated that since 1990, the average sales price has increased to \$160,000, placing home ownership out of the reach of most LMI families in the area.

Maricopa County is also in the midst of a change that dominates the financial scene in most Western states. In the past eight years there have been several large bank mergers, which has resulted in a lack of local decision-making ability. A common complaint in discussions with governmental and community representatives is that many of the decisions made, which range from loan approvals to branch closures, no longer reflect a sensitivity to the county or even the state.

In conjunction with this examination, we interviewed representatives from four community organizations. We also reviewed previous contacts with three non-profit affordable housing providers, which the OCC held in September 1999, and ten recent community contacts performed by various other banking regulatory agencies. In summary, eight of the contacts were affordable housing providers, three were small business providers, three focused on economic development and three focused on providing both affordable housing and small business loans.

The contacts indicated that community development needs in Maricopa County are similar to those throughout the country. These revolve around affordable housing and small businesses.

Affordable housing needs run the gamut from affordable rental properties to affordable properties available for purchase by LMI families. Community development needs include affordable home purchase loans for LMI individuals, subsidies for down payment assistance and closing costs, and innovative and flexible construction and renovation loans for affordable single and multi-family housing. In some parts of the city of Phoenix, FHA loans are not available. Sovereignty issues have limited lending on the local Indian reservations. Affordable housing developers have problems meeting the market driven terms offered by some of the banks and local intermediaries. And, land acquisition is growing increasingly difficult with the growth of retirement and other planned communities. Gentrification is a growing concern throughout the county.

Small business needs are the same as in other parts of the state and country. There is a need for micro loans for very small businesses and start-up small business loans. Currently, there is only one SBA micro-lender operating in the area. Start-up loans are only available through the SBA, and require a substantial equity injection. Technical assistance remains an ongoing need for small business owners. Some intervention has been provided by the local Service Core of Retired Executives (SCORE) chapters, and by the local Small Business Development Corporations (SBDCs). However, many small business owners still need education and counseling in the areas of "bootstrapping" their businesses, management of credit card debt, and developing business plans.

There is a major barrier to the CEBA banks meeting the most urgent community development needs in the area of lending. Since CEBA banks are prohibited from lending, except for the issuance of consumer credit cards, they are unable to directly meet most of the affordable housing and small business loan needs. They are also prohibited from participating in some investment-related activities, as most of the activities are centered in loan funds or consortiums. However, there are a few investment opportunities. There are also abundant opportunities for community development (CD) grants. Although several groups indicated that they had received operating or project-related grants from some of the credit card banks, they indicated the grants were small, most were less than \$10,000. And there are still opportunities for CEBA banks to provide a service in the area of consumer and small business education. There are also opportunities for the CEBA banks to make below market rate deposits at community based credit unions and community development financial institutions (CDFIs).

Conclusions About Performance

Summary

The overall level of qualified community development investments and services is adequate, relative to the opportunities available for CEBA banks in the assessment area. We based our conclusions primarily on the bank's good efforts to meet the affordable housing needs of LMI individuals in its assessment area. The bank also made an effort to help meet the needs of small businesses by making a below market rate deposit at a CDFI. The funds in turn were used to make loans to small businesses in low- and moderate-income communities.

During the review period, the bank actively sought qualified investments that focus on providing affordable housing for LMI individuals. One of the most urgent community development needs in the assessment area is CD loans. However, DMCCB is prohibited from providing community development loans because of its CEBA status. Therefore, the bank's strategy has been to focus on qualified community development investments. Due to the number of CEBA and large banks in the assessment area, there is significant competition for CD investments. During the review period, DMCCB was successful in obtaining two large investments. The investments will help provide multi-family housing for low- and moderate-income families. In addition to the investments, the bank provided grants to four affordable housing organizations to be used as down payment assistance and closing costs for LMI families.

The bank's responsiveness to community development needs is good. Community groups indicate affordable housing needs include the need for funds to build or renovate affordable multi-family housing, as well as the need to provide down payment assistance for LMI individuals who are seeking to buy single family homes in the assessment area. There is a need for start-up and micro loans for small businesses. And there is a need for consumer education. Through its community development investments, deposits, grants, and services the bank helped meet some of the most critical community development needs in the assessment area.

The investments are not innovative, but they are complex, as neither the bank nor the holding company employs individuals who have the expertise in CD investments. The bank demonstrated originality by providing a credit education video for LMI Spanish-speaking individuals who use a particular credit card product the bank provides. This video benefits individuals outside the bank’s assessment area.

Consideration of Activities that Benefit Areas Outside of the Bank’s Assessment Area

The bank has adequately addressed the needs of its assessment area; therefore, we considered investment and services that are outside of assessment area.

Qualified Investments

During the review period, DMCCB provided a total of \$10.3 million in investments and grants to community development organizations. About \$1.8 million provided a benefit to the assessment area and \$8.5 million benefited areas outside the bank’s assessment area. In addition, the bank also has ongoing investments, which total \$260 thousand from a prior review period. This information is noted in the table below.

Table 3: Qualified Investment Activity (000s)

	Benefits AA	Outside AA	Totals
Originated Investments	1,550		1,550
Originated Grants	228	8,544	8,772
Prior Period Investments		260	260
Totals	1,778	8,804	10,582

Table 4: Qualified Investment Percentages (000s)

	Benefits AA (%)	Outside AA (%)	Total (%)
Total Investments/Average Tier 1 Capital	3%	17%	20%
Total Investments/Average Total Income	1%	3%	4%
Total Investments/Average Receivables	0%	2%	2%

NOTE: Total Investments is found in Table 3. Average capital, income and receivables are found in Table 1.

The bank's most notable qualified investments in the assessment area consist of the following:

- ◆ \$1.5 million in housing bonds, which specifically supports multi-family housing for low- and moderate-income individuals and families.
- ◆ A \$50 thousand deposit in a community development financial institution, which was used to provide small business loans in low- and moderate-income communities.
- ◆ \$40 thousand in grants to four community development organizations, which provided closing costs and down payment assistance for approximately 100 LMI families.

The remaining consists of \$14 thousand, which helped provide services to low- and moderate-income individuals and \$174 thousand, which consists of Consumer Credit Counseling Services (CCCS) contributions. Data indicates that a significant number of individuals who seek credit counseling are LMI.

Since the bank's investments in its assessment area are adequate, we also considered the bank's investments/contributions outside its assessment area. Investments outside its assessment area appear to be disproportionately high due to two factors. The bank continues to hold two investments, which are shown in Table 3 as being outside the assessment area. While these investments do not benefit the bank's current assessment area, they did benefit the bank's previous assessment area prior to the move to Scottsdale in July 1998. Therefore, these investments were in the bank's assessment area during half of this review period. The dollar volume of investments outside DMCCB's assessment area is primarily affected by the large contribution to CCCS. This contribution represents \$8.5 million. Aside from these, the bank's contribution outside the assessment area is nominal, with \$5 thousand in contributions to organizations that serve low- and moderate-income individuals.

The two investments for \$260 thousand, discussed above and listed in Table 3, are investments from a prior review period. They continue to provide an ongoing benefit to the bank's previous assessment area. They are responsive to the community development needs of that assessment area, which are affordable housing and small business loans.

The bank's investments and grants in its assessment area are responsive to the community development needs. DMCCB has made a conscious effort to focus on the critical need for affordable housing. As such, a substantial majority of the bank's investments in its assessment area focus on providing down payment assistance and affordable housing for low- and moderate-income individuals. The bank also made a deposit in a CDFI, which in turn provided small business loans in LMI census tracts.

Community Development Services

The bank provided two community development services during the review period. One of the services benefited a larger regional area, including the bank's assessment area, while the other benefited an area outside the bank's assessment area. The bank used different types of media with the purpose of increasing consumer credit education to low- and moderate-income individuals. Both of the services are responsive to the need for consumer credit education. One of the services consisted of an educational pamphlet on debt and financial management, which was mailed to credit cardholders in the bank's assessment area and a larger regional area. The other service the bank provided was innovative because the bank used a means not traditionally used by financial institutions. The bank produced a Spanish language video for low- and moderate-income individuals to provide consumer credit education on how to handle credit, read monthly credit card statements, rewards of handling credit properly, etc. Each individual customer who received credit under a specific credit program outside the assessment area was given a personal copy of the video.

Compliance with Anti-Discrimination Laws and Regulations

We reviewed the bank's compliance with fair lending laws and regulations during our March 31, 2000, examination. Our examination focused on a review of the bank's fair lending policies and procedures, underwriting criteria, and scorecards. We also reviewed the bank's credit programs to ensure there were no discriminatory practices. We did not identify any violations of the substantive provisions of the anti-discrimination laws and regulations.