METRIS COMPANIES INC
Form 10-Q/A
October 22, 2002

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

FORM 10-Q/A

AMENDMENT NO. 1

(Mark One)

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2002

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: 001-12351

METRIS COMPANIES INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 41-1849591 |
| (State of Incorporation) | (I.R.S. Employer Identification No.) |

10900 Wayzata Boulevard, Minnetonka, Minnesota 55305-1534
(Address of principal executive offices)

(952) 525-5020
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed 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 X No _____

As of April 30, 2002, 62,257,143 shares of the registrant's common stock, par value $.01 per share, were outstanding.

METRIS COMPANIES INC.

FORM 10-Q

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Part I. Financial Information

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Dollars in thousands, except per-share data) (Unaudited)

| | March 31, 2002 | Dec |
|---|---|---|
| Assets: | | |
| Cash and due from banks | $ 108,597 | $ |
| Federal funds sold | 183,809 | |
| Short-term investments | 120,491 | |
| Cash and cash equivalents | 412,897 | |
| Retained interests in loans securitized | 1,338,437 | 1 |
| Less: Valuation allowance | 551,385 | |
| Net retained interests in loans securitized | 787,052 | |
| Credit card loans | 2,210,847 | 2 |
| Less: Allowance for loan losses | 416,914 | |
| Net credit card loans | 1,793,933 | 2 |
| Property and equipment, net | 111,695 | |
| Deferred tax asset | -- | |
| Purchased portfolio premium, net | 86,338 | |
| Other receivables due from credit card securitizations, net | 190,816 | |
| Other assets | 268,219 | |
| Total assets | $ 3,650,950 | $ 4 |
| Liabilities: | | |
| Deposits | $ 1,725,886 | $ 2 |
| Debt | 355,930 | |
| Accounts payable | 103,011 | |
| Deferred income | 204,528 | |
| Deferred tax liability | 26,200 | |
| Accrued expenses and other liabilities | 57,393 | |
| Total liabilities | 2,472,948 | 3 |
| Stockholders' Equity: | | |
| Convertible preferred stock - Series C, par value $.01 per share; 10,000,000 shares authorized, 1,081,435 and 1,057,638 shares issued and outstanding, respectively | 402,834 | |
| Common stock, par value $.01 per share; 300,000,000 shares authorized, 64,341,570 and 64,224,878 shares issued, respectively | 643 | |
| Paid-in capital | 234,235 | |
| Unearned compensation | (4,576) | |
| Treasury stock - 2,098,400 and 806,300 shares, respectively | (30,596) | |
| Retained earnings | 575,462 | |

| | | |
|---|---|---|
| Total stockholders' equity | 1,178,002 | 1 |
| Total liabilities and stockholders' equity | $ 3,650,950 | $ 4 |

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Statements of Income
(In thousands, except earnings per-share data) (Unaudited)

| | Three Months Ended March 31, 2002 | 2001 |
|---|---|---|
| Interest Income: | | |
| Credit card loans and retained interests in loans securitized | $ 152,214 | $ 163,522 |
| Federal funds sold | 114 | 2,311 |
| Other | 1,204 | 3,896 |
| Total interest income | 153,532 | 169,729 |
| Deposit interest expense | 23,653 | 36,623 |
| Other interest expense | 8,512 | 11,212 |
| Total interest expense | 32,165 | 47,835 |
| Net Interest Income | 121,367 | 121,894 |
| Provision for loan losses | 154,370 | 87,729 |
| Net Interest (Expense) Income After Provision for Loan Losses | (33,003) | 34,165 |
| Other Operating Income: | | |
| Net securitization and credit card servicing income | 124,118 | 87,092 |
| Credit card fees, interchange and other credit card income | 73,107 | 62,832 |
| Enhancement services revenues | 94,996 | 78,264 |
| | 292,221 | 228,188 |
| Other Operating Expense: | | |
| Credit card account and other product solicitation and marketing expenses | 40,552 | 40,765 |
| Employee compensation | 56,548 | 54,736 |
| Data processing services and communications | 22,306 | 22,379 |
| Enhancement services claims expense | 11,207 | 6,679 |
| Credit card fraud losses | 2,228 | 2,651 |
| Purchased portfolio premium amortization | 8,455 | 7,828 |
| Other | 33,092 | 36,185 |
| | 174,388 | 171,223 |
| Income Before Income Taxes and Cumulative Effect of Accounting Change | 84,830 | 91,130 |
| Income taxes | 32,490 | 35,085 |

| | | |
|---|---|---|
| Income Before Cumulative Effect of Accounting Change............. | 52,340 | 56,045 |
| Cumulative effect of accounting change (net of income taxes of $9,000)................................................. | -- | 14,499 |
| Net Income ................................................... | 52,340 | 41,546 |
| Convertible preferred stock dividends-Series C .................. | 9,188 | 8,403 |
| Net Income Applicable to Common Stockholders .................... | $ 43,152 | $ 33,143 |
| Earnings per share: | | |
| Basic-income before cumulative effect of accounting change .. | $ 0.55 | $ 0.58 |
| Basic-cumulative effect of accounting change ............... | -- | (0.15) |
| Basic-net income ......................................... | 0.55 | 0.43 |
| Diluted-income before cumulative effect of accounting change. | 0.54 | 0.57 |
| Diluted-cumulative effect of accounting change ............. | -- | (0.15) |
| Diluted-net income ....................................... | 0.54 | 0.42 |
| Shares used to compute earnings per share: | | |
| Basic ...................................................... | 96,032 | 96,660 |
| Diluted .................................................... | 96,973 | 98,445 |
| Dividends declared per common share ............................. | $ 0.01 | $ 0.01 |

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
(In thousands) (Unaudited)

| | Number of Shares Preferred | Number of Shares Common | Preferred Stock | Common Stock | Paid-in Capital | Unearned Compensation |
|---|---|---|---|---|---|---|
| BALANCE AT DECEMBER 31, 2000 | 968 | 62,243 | $ 360,421 | $ 622 | $ 198,077 | $ -- |
| Net income ............ | -- | -- | -- | -- | -- | -- |
| Cash dividends ......... | -- | -- | -- | -- | -- | -- |
| Preferred dividends in kind - Series C .... | 21 | -- | 8,109 | -- | -- | -- |
| Issuance of common stock under employee benefit plans ...... | -- | 662 | -- | 7 | 9,029 | (4,241) |
| BALANCE AT MARCH 31, 2001 ... | 989 | 62,905 | $ 368,530 | $ 629 | $ 207,106 | $ (4,241) |
| BALANCE AT DECEMBER 31, 2001 | 1,058 | 63,419 | $ 393,970 | $ 642 | $ 232,413 | $ (4,980) |
| Net income ............ | -- | -- | -- | -- | -- | -- |

| | | | | | | |
|---|---|---|---|---|---|---|
| Cash dividends ......... | -- | -- | -- | -- | -- | -- |
| Common stock repurchased | -- | (1,292) | -- | -- | -- | -- |
| Preferred dividends in kind - Series C .... | 23 | -- | 8,864 | -- | -- | -- |
| Issuance of common stock under employee benefit plans ...... | -- | 116 | -- | 1 | 1,822 | -- |
| Amortization of restricted stock ... | -- | -- | -- | -- | -- | 404 |
| BALANCE AT MARCH 31, 2002 ... | 1,081 | 62,243 | $ 402,834 | $ 643 | $ 234,235 | $ (4,576) |

See accompanying Notes to Consolidated Financial Statements.



METRIS COMPANIES INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Dollars in thousands) (Unaudited)

| | Three Months Ended March 31, 2002 | Three Months Ended March 31, 2001 |
|---|---|---|
| **Operating Activities:** | | |
| Net income ........................................ | $ 52,340 | $ 41,546 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Cumulative effect of accounting change .......... | -- | 14,499 |
| Depreciation and amortization .................. | 27,240 | 18,176 |
| Provision for loan losses ...................... | 154,370 | 87,729 |
| Retained interests valuation expense (income).... | (50,051) | (16,797) |
| Loss on derivative financial instruments ........ | 9,272 | 3,710 |
| Changes in operating assets and liabilities, net: | | |
| Deferred income taxes ..................... | 58,367 | (3,994) |
| Other receivables due from credit card securitizations ...................... | (20,220) | 7,982 |
| Accounts payable and accrued expenses ....... | (5,384) | 37,815 |
| Deferred income ........................... | (10,503) | (23,128) |
| Other ..................................... | (23,531) | (15,345) |
| Net cash provided by operating activities ........... | 191,900 | 152,193 |
| **Investing Activities:** | | |
| Net proceeds from sales and repayments of securitized loans................................ | (10,845) | 132,719 |
| Net loans originated or collected ................... | 388,194 | (290,920) |
| Additions to property and equipment ................. | (3,645) | (2,867) |
| Net cash provided by (used in) investing activities .. | 373,704 | (161,068) |
| **Financing Activities:** | | |
| (Decrease) increase in debt ......................... | (291,974) | 134 |
| Decrease in deposits ................................ | (332,122) | (31,810) |
| Cash dividends paid ................................. | (938) | (916) |
| Issuance of common stock ............................ | 1,823 | 9,036 |
| Repurchase of common stock .......................... | (17,582) | -- |
| Net cash used in financing activities ............... | (640,793) | (23,556) |

| | | |
|---|---|---|
| Net decrease in cash and cash equivalents ........... | (75,189) | (32,431) |
| Cash and cash equivalents at beginning of period ..... | 488,086 | 521,440 |
| Cash and cash equivalents at end of period .......... | $ 412,897 | $ 489,009 |
| Supplemental disclosures and cash flow information: | | |
| Cash paid during the period for: | | |
| Interest ...................................... | $ 34,261 | $ 42,090 |
| Income taxes .................................. | (17,948) | (7,831) |
| Tax benefit from employee stock option exercises.................................... | 170 | 743 |

See accompanying Notes to Consolidated Financial Statements.



METRIS COMPANIES INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
(Dollars in thousands, except as noted) (Unaudited)

NOTE 1 - ORGANIZATION AND BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Metris Companies Inc. ("MCI") and its subsidiaries, including Direct Merchants Credit Card Bank, N.A. ("Direct Merchants Bank"), which may be referred to as "we," "us," "our" and the "Company." We are an information-based direct marketer of consumer lending products and enhancement services.

We have eliminated all significant intercompany balances and transactions in consolidation. We have reclassified certain prior-period amounts to conform with the current period's presentation. We have eliminated all significant intercompany balances and transactions in consolidation. We have reclassified certain prior-period amounts to conform with the current period's presentation. Included in these reclassifications is a change to our consolidated statements of cash flows to reflect the provision for loan losses and retained interests valuation expense as an adjustment to operating activities, versus the net change in the allowance for loan losses. The impact was an increase to cash flow provided by operating activities and a decrease to cash flow provided by investing activities by $83.7 million for the three months ended March 31, 2002. The impact of this change was an increase to cash flow provided by operating activities and an increase to cash flow used by investing activities by $48.1 million for the three months ended March 31, 2001. These changes had no impact to the "Net change in cash and cash equivalents" on the consolidated statements of cash flows.

Interim Financial Statements

We have prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial statements. These interim financial statements reflect all adjustments consisting of normal recurring accruals which, in the opinion of management, are necessary to present fairly our consolidated financial position and the results of our operations and our cash flows for the interim periods. You should read these consolidated financial statements in conjunction with the financial statements and the notes thereto contained in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2001. The nature of our business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

Pervasiveness of Estimates

We have prepared the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, which require us to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. The most significant and subjective of these estimates is our determination of the adequacy of the allowance for loan losses and our determination of the fair value of retained interests from assets securitized. The significant factors susceptible to future change that have an impact on these estimates include default rates, net interest spreads, liquidity and overall economic conditions. As a result, the actual losses in our loan portfolio and the fair value of our retained interests as of March 31, 2002 and December 31, 2001 could materially differ from these estimates.



NOTE 2 - EARNINGS PER SHARE

The following table presents the computation of basic and diluted weighted-average shares used in the per-share calculations:

| | Three Months Ended March 31, 2002 | Three Months Ended March 31, 2001 |
|---|---|---|
| (In thousands) | | |
| Income before cumulative effect of accounting change ......... | $52,340 | $56,045 |
| Preferred dividends - Series C .............................. | 9,188 | 8,403 |
| Net income applicable to common stockholders before cumulative effect of accounting change ............................ | 43,152 | 47,642 |
| Cumulative effect of accounting change, net ................. | -- | 14,499 |
| Net income applicable to common stockholders ................ | $43,152 | $33,143 |
| Weighted-average common shares outstanding .................. | 62,188 | 62,303 |
| Adjustments for dilutive securities: | | |
| Assumed conversion of convertible preferred stock ........... | 33,844 | 34,357 |
| Basic common shares ......................................... | 96,032 | 96,660 |
| Assumed exercise of outstanding stock options ............... | 941 | 1,785 |
| Diluted common shares ....................................... | 96,973 | 98,445 |

NOTE 3 - ACCOUNTING CHANGES

On January 1, 2001, we adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging

Activities," which establishes accounting and reporting standards for derivative instruments. SFAS 133 requires enterprises to recognize all derivatives as either assets or liabilities in the statement of financial position and to measure those instruments at fair market value. As a result of the adoption of SFAS 133, we marked our derivatives to market value and recognized a one-time, non-cash, after-tax charge to earnings of $14.5 million. This one-time charge is reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the three months ended March 31, 2001.

On January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets," which establishes accounting and reporting standards for goodwill and other intangible assets. It requires enterprises to test these assets for impairment upon adoption of SFAS 142 as well as on an annual basis, and reduce the carrying amount of these assets if they are found to be impaired. Goodwill and other intangible assets with an indefinite useful life will no longer be amortized. Other intangible assets with an estimable useful life will continue to be amortized over their useful lives. The adoption of the new standard did not have a material impact on our financial statements.

On January 1, 2002, we adopted SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," which supersedes FASB Statement No. 121, and provides a single accounting model for long-lived assets to be disposed of. The adoption of the new standard did not have a material impact on our financial statements.



NOTE 4 - ALLOWANCE FOR LOAN LOSSES

The activity in the allowance for loan losses is as follows:

| | Three Months Ended March 31, 2002 | Three Months Ended March 31, 2001 |
|---|---|---|
| Balance at beginning of period .............. | $ 410,159 | $ 123,123 |
| Allowance transferred to the retained interests valuation allowance........... | (63,937) | (19,206) |
| Provision for loan losses ................... | 154,370 | 87,729 |
| Loans charged off ........................... | (88,891) | (52,616) |
| Recoveries .................................. | 5,213 | 4,507 |
| Net loans charged off ....................... | (83,678) | (48,109) |
| Balance at end of period .................... | $ 416,914 | $ 143,537 |

As of March 31, 2002, we had $8.4 million in credit card loans classified as non-accrual, compared to $1.3 million of credit card loans classified as non-accrual as of December 31, 2001. Credit card loans contractually 90 or more days past due and still accruing interest amounted to $124.8 million, $122.3 million and $80.7 million as of March 31, 2002, December 31, 2001 and March 31, 2001, respectively.

During the three-month period ended March 31, 2002, we transferred $63.9 million of allowance for loan losses to the valuation allowance for retained interests in loans securitized. The transfers are due to the sale of approximately $610 million of receivables from Direct Merchants Bank to the Metris Master Trust ("Master Trust") and growth in the retained interests during the first quarter of 2002. During the three-month period ended March 31, 2001, we transferred $19.2 million of allowance for loan losses to the valuation allowance for retained interests in loans securitized. This transfer was due to a decrease in the credit card portfolio and growth in gross retained interests.

NOTE 5 - RETAINED INTERESTS IN LOANS SECURITIZED

Activity in the retained interests is as follows:

| | March 31, 2002 | Change | December 31, 2001 |
|---|---|---|---|
| Gross retained interests . | $ 1,338,437 | $ 74,782 | $ 1,263,655 |
| Valuation allowance ...... | (551,385) | (13,886) | (537,499) |
| Net retained interests.... | $ 787,052 | $ 60,896 | $ 726,156 |

| | March 31, 2001 | Change | December 31, 2000 |
|---|---|---|---|
| Gross retained interests . | $ 1,910,168 | $ (113,513) | $ 2,023,681 |
| Valuation allowance ...... | (643,261) | (2,409) | (640,852) |
| Net retained interests.... | $ 1,266,907 | $ (115,922) | $ 1,382,829 |



Activity in the valuation allowance on retained interests in loans securitized is as follows:

| | Three Months Ended March 31, 2002 | 2001 |
|---|---|---|
| Balance at beginning of period ........... | $ 537,499 | $ 640,852 |
| Transfers from the allowance for loan losses ........................ | 63,937 | 19,206 |
| Retained interests valuation expense (income) ............. | (50,051) | (16,797) |
| Balance at end of period ................. | $ 551,385 | $ 643,261 |

NOTE 6 - SEGMENTS

We operate in two principal areas: consumer lending products and enhancement services. Our consumer lending products are primarily unsecured credit cards, including the Direct Merchants Bank MasterCard(R) and Visa(R). Our credit card accountholders include customers obtained from third-party lists and other customers for whom general credit bureau information is available.

We market our enhancement services, including: (1) debt waiver protection for unemployment, disability, and death; (2) membership programs such as card registration, purchase protection and other club memberships; and (3) third-party insurance, directly to our credit card accountholders and customers of third parties. We currently administer our extended service plans sold through a third-party retailer, and the customer pays the retailer directly. In addition, we develop customized targeted mailing lists from information contained in our databases for use by unaffiliated companies in their own product solicitation efforts that do not directly compete with our efforts.

We have presented the segment information reported below on a managed basis. We use this basis to review segment performance and to make operating decisions. In doing so, the income statement and balance sheet are adjusted to reverse the effects of securitizations. Presentation on a managed basis is not in conformity with accounting principles generally accepted in the United States of America. The adjustments columns in the segment table include adjustments to present the information on an owned basis as reported in the financial statements of this quarterly report.

We do not allocate the expenses, assets and liabilities attributable to corporate functions to the operating segments, such as employee compensation, data processing services and communications, third-party servicing expenses, and other expenses including occupancy, depreciation and amortization, professional fees, and other general and administrative expenses. We do not allocate capital expenditures for leasehold improvements, capitalized software and furniture and equipment to operating segments. There were no material operating assets located outside of the United States for the periods presented.

Our enhancement services operating segment pays a fee to our consumer lending products segment for successful marketing efforts to the consumer lending products segment's accountholders at a rate similar to those paid to our other third parties. Our enhancement services segment reports interest income and our consumer lending products segment reports interest expense at our weighted-average borrowing rate for the excess cash flow generated by the enhancement services segment that is used by the consumer lending products segment to fund the growth of accountholder balances.

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Three Months Ended March 31, 2002

| | Consumer Lending Products | Enhancement Services | Securitization Adjustments(a) | Other Adjustments(b) | Consolidate |
|---|---|---|---|---|---|
| Interest income. | $ 526,678 | $ 2,328 | $ (373,146) | (2,328) | $ 153,532 |
| Interest expense .... | 90,732 | -- | (56,239) | (2,328) | 32,165 |

| | | | | | |
|---|---|---|---|---|---|
| Net interest income ..... | 435,946 | 2,328 | (316,907) | -- | 121,367 |
| Other revenue .. | 130,763 | 94,996 | 66,462 | -- | 292,221 |
| Total revenue .. | 566,709 | 97,324 | (250,445) | -- | 413,588 |
| Income before income taxes. | 140,324(c) | 64,907(c) | -- | (120,401) | 84,830 |
| Total assets .... | $11,177,901 | $ 151,429 | $(8,223,360) | $544,980 (d) | $ 3,650,950 |

Three Months Ended March 31, 2001

| | Consumer Lending Products | Enhancement Services | Securitization Adjustments(a) | Other Adjustments(b) | Consolidat |
|---|---|---|---|---|---|
| Interest income. | $ 466,820 | $ 3,620 | $ (297,091) | (3,620) | $ 169,729 |
| Interest expense .... | 143,930 | -- | (92,475) | (3,620) | 47,835 |
| Net interest income ..... | 322,890 | 3,620 | (204,616) | -- | 121,894 |
| Other revenue .. | 125,371 | 78,264 | 24,553 | -- | 228,188 |
| Total revenue .. | 448,261 | 81,884 | (180,063) | -- | 350,082 |
| Income before income taxes. | 157,580(c) | 54,678(c) | -- | (121,128) | 91,130 |
| Total assets .... | $ 9,181,949 | $ 138,599 | $(6,170,284) | $ 614,197 (d) | $ 3,764,461 |

(a) This column reflects adjustments to the Company's internal financial statements, which are prepared on a managed basis, to eliminate investors' interests in securitized loans.

(b) The other adjustments column includes: intercompany eliminations and amounts not allocated to segments.

(c) Income before income taxes (and cumulative effect of accounting change) includes intercompany commissions paid by the enhancement services segment to the consumer lending products segment for successful marketing efforts to consumer lending products accountholders of $3.3 million for the three months ended March 31, 2002 and $3.2 million for the three months ended March 31, 2001.

(d) Total assets include the assets attributable to corporate functions not allocated to operating segments and the removal of investors' interests in securitized loans to present total assets on an owned basis.

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NOTE 7 - SHAREHOLDERS' EQUITY

On February 6, 2001, the Board of Directors authorized a share repurchase program of up to $200 million of our outstanding common stock over a period ending December 31, 2002. The amount of common stock we can repurchase in a calendar year is limited under its various debt agreements. For the three months ended March 31, 2002, 1,292,100 common shares had been repurchased under the program for $17.6 million. In 2002, we may repurchase up to an additional $77 million of common stock.

The purpose of the Metris Companies Inc. stock repurchase program is to purchase outstanding stock for later reissuance under our stock option and employee benefit plans or potential acquisition opportunities. During the first quarter of 2002 and 2001, the Company issued 116,000 and 662,000 shares of common stock, respectively, under its employee benefit plans for net cash proceeds of $1.8 million and $4.8 million, respectively.

NOTE 8 - SUBSEQUENT EVENT

On April 16, 2002, Direct Merchants Bank entered into an agreement with the Office of the Comptroller of the Currency ("OCC") to strengthen the safety and soundness of Direct Merchants Bank's operations. The agreement formalizes recommendations made and requirements imposed by the OCC following an examination of Direct Merchants Bank that covered the 15-month period ended December 31, 2001. On April 17, 2002, Metris Companies Inc. filed the agreement with the Securities and Exchange Commission as an exhibit to a current report on Form 8-K. We filed an amendment to that current report on Form 8-K on October 22, 2002.

NOTE 9 - SUPPLEMENTAL CONSOLIDATING FINANCIAL STATEMENTS

We have various indirect subsidiaries which do not guarantee company debt. We have presented the following condensed consolidating financial statements of the Company, the guarantor subsidiaries and the non-guarantor subsidiaries to comply with SEC reporting requirements. We have not presented separate financial statements of the guarantor and non-guarantor subsidiaries because management has determined that the subsidiaries' financial statements would not be material to investors.

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METRIS COMPANIES INC.
Supplemental Consolidating Balance Sheets
March 31, 2002
(Dollars in thousands)
Unaudited

| | Metris Companies Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Elimin |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Assets: | | | | |
| Cash and cash equivalents ................ | $ 5,092 | $ 1,870 | $ 405,935 | $ |
| Net retained interests in loans securitized .................... | -- | -- | 787,052 | |
| Credit card loans, net of allowance ...... | 9,451 | -- | 1,784,482 | |
| Property and equipment, net ............. | -- | 76,032 | 35,663 | |
| Purchased portfolio premium ............. | 248 | -- | 86,090 | |
| Other receivables due from credit card securitizations, net................. | 7 | -- | 190,809 | |
| Other assets ........................... | 9,866 | 52,204 | 211,987 | ( |
| Investment in subsidiaries .............. | 1,956,055 | 1,778,331 | -- | (3,73 |
| Total assets ........................... | $ 1,980,719 | $ 1,908,437 | $ 3,502,018 | $(3,74 |
| Liabilities: | | | | |
| Deposits ............................... | $ (1,000) | $ -- | $ 1,726,886 | $ |
| Debt ................................... | 346,146 | 69 | 9,715 | |
| Accounts payable ....................... | 4,362 | 11,807 | 89,761 | ( |
| Deferred income ........................ | 804 | 25,897 | 180,746 | ( |
| Deferred tax liability .................. | 4,795 | (7,207) | 28,612 | |
| Accrued expenses and other liabilities......................... | 447,610 | (78,184) | (312,033) | |
| Total liabilities ...................... | 802,717 | (47,618) | 1,723,687 | ( |
| Total stockholders' equity .............. | 1,178,002 | 1,956,055 | 1,778,331 | (3,73 |
| Total liabilities and stockholders' equity................. | $ 1,980,719 | $ 1,908,437 | $ 3,502,018 | $(3,74 |



METRIS COMPANIES INC.
Supplemental Consolidating Balance Sheets
December 31, 2001
(Dollars in thousands)
Unaudited

| | Metris Companies Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Elimination |
|---|---|---|---|---|
| Assets: | | | | |
| Cash and cash equivalents ........... | $ 17,613 | $ 1,505 | $ 468,968 | $ -- |
| Net retained interests in loans securitized ...................... | -- | -- | 726,156 | -- |
| Credit card loans, net of allowance .. | 1,646 | -- | 2,334,851 | -- |
| Property and equipment, net ......... | -- | 78,425 | 36,488 | -- |
| Deferred income taxes ............... | (31,921) | 4,937 | 59,151 | -- |
| Purchased portfolio premium ......... | 248 | -- | 94,545 | -- |
| Other receivables due from credit card securitizations, net ............. | 34 | 644 | 179,190 | -- |
| Other assets ........................ | 10,145 | 50,794 | 201,525 | (6,258 |

| | | | | |
|---|---|---|---|---|
| Investment in subsidiaries .......... | 1,900,528 | 1,745,701 | -- | (3,646,229 |
| Total assets ........................ | $ 1,898,293 | $ 1,882,006 | $ 4,100,874 | $(3,652,487 |
| Liabilities: | | | | |
| Deposits ............................ | $ (1,000) | $ -- | $ 2,059,008 | $ -- |
| Debt ................................ | 345,924 | 171 | 301,809 | -- |
| Accounts payable .................... | 3,070 | 15,461 | 68,073 | (3,129 |
| Deferred income ..................... | 3,270 | 30,615 | 184,275 | (3,129 |
| Accrued expenses and other liabilities .................... | 405,074 | (64,769) | (257,992) | -- |
| Total liabilities ................... | 756,338 | (18,522) | 2,355,173 | (6,258 |
| Total stockholders' equity .......... | 1,141,955 | 1,900,528 | 1,745,701 | (3,646,229 |
| Total liabilities and stockholders' equity ............ | $ 1,898,293 | $ 1,882,006 | $ 4,100,874 | $(3,652,487 |

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METRIS COMPANIES INC.
Supplemental Consolidating Statements of Income
Three Months Ended March 31, 2002
(Dollars in thousands)
Unaudited

| | Metris Companies Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations |
|---|---|---|---|---|
| Net Interest (Expense) Income .......................... | $ (5,482) | $ (1,173) | $ 128,022 | $ -- |
| Provision for loan losses ........... | 65 | -- | 104,305 | 50,000 |
| Net Interest Expense After Provision for Loan Losses.................. | (5,547) | (1,173) | 23,717 | (50,000) |
| Other Operating Income: | | | | |
| Net securitization and credit card servicing income........................... | 2,378 | -- | 121,740 | -- |
| Credit card fees, interchange and other credit card income............... | (2,079) | 7,923 | 131,709 | (64,446) |
| Enhancement services revenues......................... | -- | 16,163 | 78,833 | -- |
| Intercompany allocations ............ | 30 | 53,073 | 9,661 | (62,764) |

| | | | | |
|---|---|---|---|---|
| | 329 | 77,159 | 341,943 | (127,210) |
| Other Operating Expense: | | | | |
| Credit card account and other product solicitation and marketing expenses................ | -- | 3,229 | 37,323 | -- |
| Employee compensation ................ | 404 | 49,168 | 6,976 | -- |
| Data processing services and communications ............... | 23 | (19,562) | 45,211 | (3,366) |
| Enhancement services claims expense........................... | -- | (513) | 11,720 | -- |
| Credit card fraud losses ............. | (8) | -- | 2,236 | -- |
| Purchased portfolio premium amortization .................... | -- | -- | 10,444 | (1,989) |
| Other ............................... | 43 | 26,348 | 8,661 | (1,960) |
| Intercompany allocations ............. | (509) | 18,078 | 45,195 | (62,764) |
| | (47) | 76,748 | 167,766 | (70,079) |
| (Loss) Income Before Income Taxes and Equity in Income of Subsidiaries............ | (5,171) | (762) | 197,894 | (107,131) |
| Income taxes ......................... | (1,980) | (292) | 75,793 | (41,031) |
| Equity in income of subsidiaries..................... | 55,531 | 122,101 | -- | (177,632) |
| Net Income .......................... | $ 52,340 | $ 121,631 | $ 122,101 | $(243,732) |

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METRIS COMPANIES INC.
Supplemental Consolidating Statements of Income
Three Months Ended March 31, 2001
(Dollars in thousands)
Unaudited

| | Metris Companies Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Elimination |
|---|---|---|---|---|
| Net Interest (Expense) Income ........................... | $ (35,551) | $ (1,430) | $ 158,875 | $ -- |
| Provision for loan losses ............ | 204 | -- | 87,525 | -- |
| Net Interest (Expense) Income After Provision for Loan Losses.......... | (35,755) | (1,430) | 71,350 | -- |
| Other Operating Income: | | | | |
| Net securitization and credit card servicing income........................... | 2,378 | -- | 84,714 | -- |
| Credit card fees, interchange and other credit card income................ | (1,289) | (6,788) | 71,111 | (202 |

| | | | | |
|---|---|---|---|---|
| Enhancement services revenues | -- | 17,118 | 61,146 | -- |
| | 1,089 | 10,330 | 216,971 | (202 |
| Other Operating Expense: | | | | |
| Credit card account and other product solicitation and marketing expenses | -- | 6,120 | 34,645 | -- |
| Employee compensation | -- | 43,411 | 11,325 | -- |
| Data processing services and communications | -- | (30,533) | 52,912 | -- |
| Enhancement services claims expense | -- | 167 | 6,512 | -- |
| Credit card fraud losses | -- | -- | 2,651 | -- |
| Purchased portfolio premium amortization | -- | -- | 7,828 | -- |
| Other | 38 | 18,462 | 17,685 | -- |
| | 38 | 37,627 | 133,558 | -- |
| (Loss) Income Before Income Taxes, Equity in Income of Subsidiaries and Cumulative Effect of Accounting Change | (34,704) | (28,727) | 154,763 | (202 |
| Income taxes | (13,361) | (11,970) | 60,494 | (78 |
| Equity in income of subsidiaries | 62,889 | 79,770 | -- | (142,659 |
| Income Before Cumulative Effect of Accounting Change | 41,546 | 63,013 | 94,269 | (142,783 |
| Cumulative effect of accounting change, net | -- | -- | 14,499 | -- |
| Net Income | $ 41,546 | $ 63,013 | $ 79,770 | $(142,783 |



METRIS COMPANIES INC.
Supplemental Condensed Consolidating Statements of Cash
Three Months Ended March 31, 2002
(Dollars in thousands)
Unaudited

| | Metris Companies Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminatio |
|---|---|---|---|---|
| Operating Activities: | | | | |
| Net cash provided by operating activities | $ 67,286 | $ 36,732 | $ 199,414 | $(111,53 |

| | | | | |
|---|---|---|---|---|
| Investing Activities: | | | | |
| Net proceeds from sales and repayments of securitized loans .. | -- | -- | (10,845) | - |
| Net loans originated or collected .... | (7,805) | -- | 395,999 | - |
| Additions to property and equipment .. | -- | (3,631) | (14) | - |
| Investment in subsidiaries .......... | (55,527) | (32,630) | -- | 88,15 |
| Net cash (used in) provided by investing activities............. | (63,332) | (36,261) | 385,140 | 88,15 |
| Financing Activities: | | | | |
| Increase (decrease) in debt .......... | 222 | (102) | (292,094) | - |
| Decrease in deposits ................ | -- | -- | (332,122) | - |
| Cash dividends paid ................. | (938) | -- | -- | - |
| Issuance of common stock ............ | 1,823 | -- | -- | - |
| Repurchase of common stock .......... | (17,582) | -- | -- | - |
| Capital contributions ............... | -- | (4) | (23,371) | 23,37 |
| Net cash used in financing activities. | (16,475) | (106) | (647,587) | 23,37 |
| Net (decrease) increase in cash and cash equivalents................. | (12,521) | 365 | (63,033) | - |
| Cash and cash equivalents at beginning of period.............. | 17,613 | 1,505 | 468,968 | - |
| Cash and cash equivalents at end of period.......................... | $ 5,092 | $ 1,870 | $ 405,935 | $ - |



METRIS COMPANIES INC.
Supplemental Condensed Consolidating Statements of Cash Flow
Three Months Ended March 31, 2001
(Dollars in thousands)
Unaudited

| | Metris Companies Inc. | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminatio |
|---|---|---|---|---|
| Operating Activities: | | | | |
| Net cash (used in) provided by operating activities............. | $ (7,013) | $ 86,318 | $ 215,422 | $(142,53 |
| Investing Activities: | | | | |
| Net proceeds from sales and repayments of securitized loans... | 1,487 | 4 | 131,228 | - |
| Net loans originated or collected .... | (12,157) | -- | (278,763) | - |
| Dispositions of (additions to) property and equipment........... | -- | 4,271 | (7,138) | - |
| Investment in subsidiaries .......... | (63,034) | (94,322) | -- | 157,35 |
| Net cash used in investing activities. | (73,704) | (90,047) | (154,673) | 157,35 |
| Financing Activities: | | | | |

| | | | | |
|---|---|---|---|---|
| Increase (decrease) in debt .......... | 222 | (3) | (85) | - |
| Decrease in deposits ................. | -- | -- | (31,810) | - |
| Cash dividends paid .................. | (916) | -- | -- | - |
| Issuance of common stock ............. | 9,036 | -- | -- | - |
| Capital contributions ................ | -- | 145 | 14,677 | (14,82 |
| Net cash provided by (used in) financing activities............. | 8,342 | 142 | (17,218) | (14,82 |
| Net (decrease) increase in cash and cash equivalents.................. | (72,375) | (3,587) | 43,531 | - |
| Cash and cash equivalents at beginning of period.............. | 64,869 | 10,658 | 445,913 | - |
| Cash and cash equivalents at end of period........................... | $ (7,506) | $ 7,071 | $ 489,444 | $ - |

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ITEM 2.

METRIS COMPANIES INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis provides information management believes to be relevant to understanding the financial condition and results of operations of Metris Companies Inc. ("MCI") and its subsidiaries, including Direct Merchants Credit Card Bank, N.A. ("Direct Merchants Bank"), which may be referred to as "we," "us," "our" and the "Company." You should read this discussion along with the following documents for a full understanding of our financial condition and results of operations: Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2001; and our Proxy Statement for the 2002 Annual Meeting of Shareholders. In addition, you should read this discussion along with our Quarterly Report on Form 10-Q/A for the period ended March 31, 2002, of which this commentary is a part, and the condensed consolidated financial statements and related notes thereto.

Results of Operations

Net income for the three months ended March 31, 2002 was $52.3 million, up from $41.5 million for the first quarter of 2001. Net income reported for the three months ended March 31, 2001 includes $14.5 million of a cumulative effect of accounting change described below. Without this item, reported earnings would have been $56.0 million for the three months ended March 31, 2001. Diluted earnings per share for the three months ended March 31, 2002 was $0.54 compared to $0.42 per share for the first quarter of 2001. Without the impact of the cumulative effect of accounting change, diluted earnings per share would have been $0.57 for the three months ended March 31, 2001. The $3.7 million reduction in income before the cumulative effect of accounting change is primarily due to an increase in provision for loan losses, partially offset by increases in other operating income. The increase in the provision relates to the estimated required balance in the allowance for loan losses to cover future charge-offs inherent in our credit card loan portfolio as of March 31, 2002. Higher credit card loan balances, increased net charge-offs, increased delinquency rates and the current economic environment were some of the factors considered by management in determining the necessary balance in the allowance for loan losses. Other operating income increased 28% to $292.2 million for the three months ended March 31, 2002 from $228.2 million for the same period in 2001. Net securitization and credit card servicing income, a component of other operating income, increased 43% to $124.1 for the first quarter of 2002 from $87.1 million for the same period in 2001, primarily due to the $2.1 billion increase in securitized receivables and lower costs of funds offset by increased charge-offs. Enhancement services revenue also increased 21% to $95.0 million for the first quarter of 2002 compared to the same period in 2001. These increases were primarily due to the growth in total credit card accounts, an increase in outstanding receivables in the managed credit card loan portfolio, development of new third-party relationships and the creation of new products.

On January 1, 2001, we adopted Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," which establishes accounting and reporting standards for derivative instruments. SFAS 133 requires enterprises to recognize all derivatives as either assets or liabilities in the statement of financial position and to measure those instruments at fair value. Prior to SFAS 133, we amortized the costs of interest rate contracts on a straight-line basis over the expected life of the contract. The adoption of SFAS 133 resulted in a one-time, non-cash, after-tax charge to earnings of $14.5 million reflected as a

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"Cumulative effect of accounting change" in the consolidated statements of income for the three months ended March 31, 2001.

Critical Accounting Policies

The Company's most significant accounting policies are our determination of the allowance for loan losses, valuation of retained interests and accounting for deferred origination costs.

Allowance for loan losses

We maintain an allowance for loan losses sufficient to cover anticipated probable loan losses inherent in the credit card loan portfolio as of the balance sheet date. The allowance is based on management's consideration of all relevant factors including management's assessment of applicable economic and seasonal trends. In addition, we have incorporated updated regulatory guidance regarding analysis and documentation for the allowance for loan losses.

We segment the loan portfolio into several individual static pools with similar credit risk and time since solicitation (vintage pools), and estimate (based on historical experience and existing environmental conditions) the dollar amount of principal, accrued finance charges and fees in each 30-day delinquency bucket that will not be collected and, therefore, "roll" into the next 30-day bucket and ultimately charge off. We then aggregate these pools into prime and sub-prime portfolios based on the prescribed FICO score cuts and into several other groups such as credit counseling and payment alternative receivables. We also isolate individual pools subsequent to solicitation when the credit risk associated with the pools include higher risk segments, such as our partially secured card program, accounts that are over their credit limit by more than 10%, accounts receiving benefits under our debt waiver program and other programs as deemed necessary. We separately analyze the reserve requirement on each of these groups or portfolios.

We continually evaluate the homogenous static risk pools using a roll rate model which uses historical delinquency levels and pay-down levels (12 months of historical data, with significant influence given to last six months' performance to capture current economic and seasonal trends), loan seasoning and other measures of asset quality to estimate charge-offs for both credit loss and bankruptcy losses.

Additionally, in evaluating the adequacy of the loan loss reserves, we consider several subjective factors which may be overlaid into the credit risk roll-rate model in determining the necessary loan loss reserve, including:

- national and economic trends and business conditions, including the condition of various market segments;
- changes in lending policies and procedures, including those for underwriting, collection, charge-off and recovery, as well as the experience, ability and depth of lending management and staff;
- trends in volume and the product pricing of accounts, including any concentrations of credit; and
- impacts from external factors, such as changes in competition, and legal and regulatory requirements, on the level of estimated credit losses in the current portfolio.

Significant changes in these factors could impact our financial projections and thereby affect the adequacy of our allowance for loan losses.



The loan loss allowance methodology and calculation was revised in the first quarter of 2002. The significant changes reflected in this revised methodology are as follows:

- reserving for twelve months (versus six months) of estimated losses on the static pool of our core prime receivables; and
- establishing a judgmental reserve for accounts over their credit limit, accounts under specific payment programs and accounts receiving benefits under our debt waiver program (versus including these items in our roll rate methodology).

Retained interests

The Company determines the fair value of the net retained interests by calculating the present value of future expected cash flows using management's best estimate of key assumptions including credit losses, weighted-average spreads, payment rates and a discount rate commensurate with the risks involved.

For purposes of determining the value of the retained interests, we have included only cash flows associated with the excess spread and principal receivables included in the retained interests as of the balance sheet date. We have not included certain expected finance charge receivable cash flows in our calculation.

The significant assumptions used for estimating the fair value of the retained interest in loans securitized are as follows:

| | March 31, 2002 | December 31, 2001 |
|---|---|---|
| Annual discount rate (1) .......................... | 15% | 15% |

| | | |
|---|---|---|
| Monthly payment rate ............................. | 6% | 7% |
| Weighted-average spread (2) ....................... | 21% | 20% |
| Annual principal, finance charge and fees default rate............................ | 19% | 18% |

(1) If we had included all expected finance charge receivable cash flows, our effective discount rate would have ranged from 35% to 45%.
(2) Includes finance charges, late fees and overlimit fees, less weighted-average cost of funds and 2% servicing fee.

Deferred acquisition costs

We defer direct credit card origination costs associated with successful credit card solicitations that we incur in transactions with independent third parties, and certain other costs that we incur in connection with loan underwriting and the preparation and processing of loan documents. We also defer qualifying acquisition costs associated with our enhancement services products. These costs, which relate directly to membership solicitations (direct response advertising costs), principally include postage, printing, mailings and telemarketing costs. The total amount of deferred costs as of March 31, 2002 and December 31, 2001 were $89.3 million and $89.5 million, respectively. The most significant assumption we used in determining the realizability of these deferred costs is future revenues from our credit cards and enhancement services products. A significant reduction in revenues could have a material impact on the values of these balances.

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Deferred revenue on Enhancement Services products

Direct Merchants Bank offers various debt waiver products to its credit card accountholders. Revenue for such products is recognized in the month following completion of the cancellation period, and reserves are provided for pending claims based on Direct Merchants Bank's historical experience with settlement of such claims. Unearned revenues and reserves for pending claims are recorded as "Deferred income" and "Accrued expenses and other liabilities," respectively. We record fees on membership programs as deferred income upon acceptance of membership and amortize them on a straight-line basis over the membership period beginning after the contractual cancellation period is complete. We defer and recognize extended service plan revenues and the incremental direct acquisition costs on a straight-line basis over the life of the related extended service plan contracts beginning after the expiration of any manufacturers' warranty coverage.

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Net interest income consists primarily of interest earned on our credit card loans and retained interests in loans securitized, less interest expense on borrowings to fund loans. Table 1 provides an analysis of interest income and expense, net interest spread, net interest margin and average balance sheet data for the three month periods ended March 31, 2002 and 2001.

Table 1: Analysis of Average Balances, Interest and Average Yields and Rates
(Dollars in thousands)

Three Months Ended March 31,

| | 2002 | | | |
|---|---|---|---|---|
| | Average Balance | Interest | Yield/ Rate | Average Balance |
| Assets: | | | | |
| Interest-earning assets: | | | | |
| Federal funds sold ............ | $ 28,431 | $ 114 | 1.6% | $ 164,574 |
| Short-term investments ........ | 271,628 | 1,204 | 1.8% | 280,379 |
| Credit card loans and retained interests in loans securitized .................. | 3,887,955 | 152,214 | 15.9% | 3,343,477 |
| Total interest-earning assets | $ 4,188,014 | $ 153,532 | 14.9% | $ 3,788,430 |
| Other assets .................. | 759,353 | -- | -- | 806,136 |
| Allowances for loan losses and retained interests valuation allowance .......... | (988,054) | -- | -- | (781,211 ) |
| Total assets .................. | $ 3,959,313 | -- | -- | $ 3,813,355 |
| Liabilities and Equity: | | | | |
| Interest-bearing liabilities: | | | | |
| Deposits ...................... | $ 1,930,007 | $ 23,653 | 5.0% | $ 2,130,414 |
| Debt .......................... | 356,019 | 8,512 | 9.7% | 360,999 |
| Total interest-bearing liabilities ................ | $ 2,286,026 | $ 32,165 | 5.7% | $ 2,491,413 |
| Other liabilities ............. | 519,185 | -- | -- | 412,839 |
| Total liabilities ............. | 2,805,211 | -- | -- | 2,904,252 |
| Stockholders' equity .......... | 1,154,102 | -- | -- | 909,103 |
| Total liabilities and equity... | $ 3,959,313 | -- | -- | $ 3,813,355 |
| Net interest income and interest margin (1) ........ | -- | $ 121,367 | 11.8% | -- |
| Net interest rate spread (2) | -- | -- | 9.2% | -- |
| Return on average assets ...... | -- | -- | 5.4% | -- |
| Return on average total equity ..................... | -- | -- | 18.4% | -- |

(1) We compute net interest margin by dividing annualized net interest income by average total interest-earning assets.

(2) The net interest rate spread is the annualized yield on average interest-earning assets minus the annualized funding rate on average interest-bearing liabilities.

Net interest income decreased $0.6 million to $121.4 million for the quarter ended March 31, 2002 from $122.0 million for the quarter ended March 31, 2001. The decrease primarily relates to a decrease in the yield on credit card loans and retained interests in loans securitized from 19.8% to 15.9%, partially offset by a rate decrease on interest-bearing liabilities from 7.8% for the three months ended March 31, 2001 to 5.7% for the three months ended March 31, 2002.

Other Operating Income

Other operating income contributes substantially to our results of operations, representing 71% and 65% of total revenues for the three-month periods ended March 31, 2002 and 2001, respectively.

Other operating income increased $64.0 million for the three months ended March 31, 2002 over the comparable period in 2001. This increase is due to the $37.0 million increase in net securitization and credit card servicing income. The increase in net securitization and credit card servicing income was primarily due to the change in the retained interests valuation expense needed to record the retained interests at fair value. The retained interests valuation expense decreased $33.3 million for the three months ended March 31, 2002 versus the three months ended March 31, 2001.

Credit card fees, interchange and other credit card income increased $10.3 million to $73.1 million for the three months ended March 31, 2002 over the comparable period in 2001 due to the growth in loans in the credit card portfolio and retained interests partially offset by increased finance charge and fee charge-offs. Average credit card loans and retained interests increased to $3.9 billion for the three months ended March 31, 2002, compared to $3.3 billion for the same period in 2001.

Enhancement services revenues increased by $16.7 million for the three months ended March 31, 2002, compared to the three months ended March 31, 2001. This increase reflects higher credit protection revenue due to increased covered receivables and higher sales of our debt waiver products, as well as the increase in membership program revenues resulting from additional product offers to third-party cardholders.

Other Operating Expense

Total other operating expenses for the three months ended March 31, 2002 increased $3.2 million over the comparable period in 2001, largely due to costs associated with the growth of our business activities. Employee compensation increased $1.8 million for the three month ended March 31, 2002 due to increased staffing needs. Enhancement services claims expense increased $4.5 million for the three months ended March 31, 2002 due to growth in debt waiver covered receivables. Other expenses decreased $3.1 million for the three months ended March 31, 2002 due to decreased professional fees, related legal expenses and insurance reimbursements.

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Asset Quality

Our delinquency and net loan charge-off rates at any point in time reflect, among other factors, the credit risk of loans, the average age of our various credit card account portfolios, the success of our collection and recovery efforts, and general economic conditions. The average age of our credit card account portfolio affects the stability of delinquency and loss rates. In order to minimize losses, we continue to focus our resources on refining our credit underwriting standards for new accounts, and on collections and post charge-off recovery efforts. At March 31, 2002, 55% of our outstanding receivables balance were from credit card accounts that have been with us in excess of two years, and 33% of outstanding receivables were with us in excess of four years.

We use credit line analyses, account management and customer transaction authorization procedures to minimize loan losses. Our risk models determine initial credit lines at the time of solicitation. We manage credit lines on an ongoing basis and adjust them based on customer usage and payment patterns. To maximize profitability, we continually monitor customer accounts and initiate appropriate collection activities when an account is delinquent or overlimit.

Delinquencies

Delinquencies not only have the potential to affect earnings in the form of net loan losses, but they are also costly in terms of the personnel and other resources dedicated to their resolution. It is our policy to continue to accrue interest and fee income on all credit card accounts until we charge off the account, except in limited circumstances. FFIEC (Federal Financial Institutions Examination Council) guidelines with respect to credit card issuers permit the re-aging of past due accounts to current status only after receiving the equivalent of three minimum payments or one lump sum equivalent. Furthermore, accounts can only be re-aged to current status once every twelve months and twice every five years. Table 2 presents the delinquency trends of our credit card loan portfolio.

Table 2: Loan Delinquency
(Dollars in thousands)

| | March 31, 2002 | % of Total | December 31, 2001 | % of Total | March 31, 2001 |
|---|---|---|---|---|---|
| Loans outstanding ... | $2,210,847 | 100% | $2,746,656 | 100% | $1,402,808 |
| Loans contractually delinquent: | | | | | |
| 30 to 59 days .. | 55,101 | 2.5% | 87,603 | 3.2% | 50,078 |
| 60 to 89 days .. | 38,023 | 1.7% | 66,647 | 2.4% | 40,843 |
| 90 or more days. | 133,223 | 6.0% | 123,528 | 4.5% | 80,733 |
| Total ....... | $ 226,347 | 10.2% | $ 277,778 | 10.1% | $ 171,654 |

The 200-basis-point decrease in the delinquency rates over March 31, 2001 reflects the run-off of our partially secured credit card portfolio.

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Net Charge-Offs

Net charge-offs are the principal amount of losses from credit card accountholders unwilling or unable to make minimum payments, bankrupt credit card accountholders and deceased credit card accountholders, less current period recoveries. Net charge-offs exclude accrued finance charges and fees, which are charged against the related income at the time of charge-off. The following table presents our net principal charge-offs for the periods indicated as reported in the consolidated financial statements.

Table 3: Net Charge-offs
(Dollars in thousands) Three Months Ended

| | March 31, 2002 | March 31, 2001 |
|---|---|---|
| Average credit card loans .......... | $2,052,596 | $1,298,748 |
| Net charge-offs .................... | 83,678 | 48,109 |
| Net charge-off ratio ............... | 16.5% | 15.0% |

The increase in the net charge off ratios for the three months ended March 31, 2002 primarily reflects a decrease in the loan growth, a deterioration in the economy and the impact of the 2001 credit line increase program.

Provision and Allowance for Loan Losses

We make provisions for loan losses in amounts necessary to maintain the allowance at a level estimated to be sufficient to absorb probable future loan losses, net of recoveries, inherent in the loan portfolio.

The economy has slowed down significantly over the last year, exacerbated by the terrorist attacks on September 11, 2001. Also, our 2001 credit line increase program added pressure to some of our customers, due to increased average outstanding balances which require higher monthly payments. This, along with a deteriorating economy, has made our collection efforts more difficult, resulting in higher delinquencies. This changing environment has caused our delinquencies and losses to increase from prior years' levels. Some of the actions we are taking to mitigate this slowdown include expanding our collections strategies to aggressively address any potential delinquency increases and using our recovery staff to work on precharge-off receivables. We also leverage debt forbearance programs and credit counseling services for qualifying credit card accountholders that are experiencing payment difficulties. These programs include reduced interest rates, reduced or suspended fees and other incentives to induce the customer to continue making payments. The amount of customer receivables in debt forbearance programs was $108.5 million or 5% of credit card loans as of March 31, 2002, compared with $129.9 million or 5% of credit card loans as of December 31, 2001. All delinquent receivables in debt forbearance programs are included in Table 2.

The provision for loan losses was $154.4 million for the three months ended March 31, 2002, compared to $87.7 million for the three months ended March 31, 2001. The ratio of allowance for loan losses to period-end loans was 18.9% at March 31, 2002, compared to 14.9% at December 31, 2001. The allowance for loan losses as a percentage of 30-day plus receivables was 184.2% at March 31, 2002 and 147.7% at December 31, 2001.

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Retained Interest Valuation

We record a valuation allowance to reduce the contractual value of the retained interests in loans securitized to fair value. The following summarizes our retained interests as of March 31, 2002, December 31, 2001, March 31, 2001 and December 31, 2000.

| | March 31, 2002 | Change | December 31, 2001 |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Gross retained interests ..... | $ 1,338,437 | $ 74,782 | $ 1,263,655 |
| Valuation allowance .......... | (551,385) | (13,886) | (537,499) |
| Net retained interests........ | $ 787,052 | $ 60,896 | $ 726,156 |

| | March 31, 2001 | Change | December 31, 2000 |
|---|---|---|---|
| Gross retained interests ..... | $ 1,910,168 | $ (113,513) | $ 2,023,681 |
| Valuation allowance .......... | (643,261) | (2,409) | (640,852) |
| Net retained interests........ | $ 1,266,907 | $ (115,922) | $ 1,382,829 |

Gross retained interests in loans securitized increased by $74.8 million between December 31, 2001 and March 31, 2002, to $1.3 billion. The increase is due to the sale of approximately $610 million of receivables from Direct Merchants Bank to the Master Trust during the three months ended March 31, 2002. During the three months ended March 31, 2002, the valuation allowance increased by $13.9 million, primarily due to the higher gross retained interests and a higher projected default rate partially offset by an increase in the projected weighted-average spread. The projected default rate increased from 18% as of December 31, 2001 to 19% as of March 31, 2002. The increase in the projected default rate was due to increased delinquencies in the Master Trust and the overall deterioration in the economy. The increase in the projected default rate caused an appproximate $30 million increase in the valuation allowance. The projected weighted-average spread increased from 20% as of December 31, 2001 to 21% as of March 31, 2002. The increase in the projected weighted-average spread is due to lower costs of funds and the impact of interest rate floors on credit card accounts.

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Balance Sheet Analysis

Credit Card Loans

Credit card loans were $2.2 billion as of March 31, 2002, compared to $2.7 billion as of December 31, 2001. The $0.5 billion decrease is primarily a result of the transfer of $610 million of receivables from Direct Merchants Bank to the Metris Master Trust.

Deferred Tax Asset/Liability

Total deferred tax asset/liability decreased to a net liability of $26.2 million as of March 31, 2002 from a net tax asset of $32.2 million as of December 31, 2001. The decrease in net asset/liability is the result of various timing differences between accounting principles generally accepted in the United States of America and tax accounting.

Debt

Debt decreased to $355.9 million as of March 31, 2002 from $647.9 million as of December 31, 2001 due to the paydown of a warehouse financing arrangement entered into by Direct Merchants Bank in June 2001 that was accounted for as a collateralized financing.

Deferred Income

Deferred income decreased $10.5 million to $204.5 million as of March 31, 2002 compared to $215.0 million as of December 31, 2001. The decrease primarily relates to our migration from annual-billed to monthly-billed products.

Stockholders' Equity

Stockholders' equity was $1.2 billion as of March 31, 2002, an increase of $36.0 million over December 31, 2001 stockholders' equity of $1.1 billion. The increase results from net income of $52.3 million and $1.8 million stock issuances under employee benefit plans offset by cash dividends of $0.9 million and $17.6 million of stock repurchases under our stock repurchase program.

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Liquidity, Funding and Capital Resources

One of our primary financial goals is to maintain an adequate level of liquidity through active management of assets and liabilities. Because the pricing and maturity characteristics of our assets and liabilities change, liquidity management is a dynamic process, affected by changes in short- and long-term interest rates. We use a variety of financing sources to manage liquidity, refunding, and interest rate risks. Table 4 summarizes our funding and liquidity as of March 31, 2002 and December 31, 2001:

Table 4: Liquidity, Funding and Capital Resources
(Dollars in thousands)

| | March 31, 2002 | | December 31, 2001 | |
|---|---|---|---|---|
| On-balance sheet funding | Outstanding | Unused Capacity | Outstanding | Unused Capacity |
| Bank conduit 2002 ........ | $ -- | $ 400,000 | $ 292,000 | $ 108,000 |
| Revolving credit line 2003 | -- | 170,000 | -- | 170,000 |
| Term loan 2003 .......... | 100,000 | N/A | 100,000 | N/A |
| Senior notes 10% 2004 .... | 100,000 | N/A | 100,000 | N/A |
| Senior notes 10.125% 2006 | 146,146 | N/A | 145,924 | N/A |
| Other ................... | 9,784 | N/A | 9,980 | N/A |
| Deposits ................ | 1,725,886 | N/A | 2,058,008 | N/A |
| Equity .................. | 1,178,002 | N/A | 1,141,955 | N/A |
| Subtotal ........... | $ 3,259,818 | $ 570,000 | $3,847,867 | $ 278,000 |
| Off-balance sheet funding | | | | |
| Metris Master Trust | $ 8,223,360 | $ 585,890 | $ 7,880,342 | $ 328,908 |
| Metris facility ... | -- | 75,000 | 15,500 | 59,500 |
| Various conduits .. | -- | 850,000 | -- | -- |
| Subtotal ..... | $ 8,223,360 | $ 1,510,890 | $ 7,895,842 | $ 388,408 |
| Total ........ | $11,483,178 | $ 2,080,890 | $11,743,709 | $ 666,408 |

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Under our revolving line of credit agreement, we need to maintain, among other items, minimum equity plus reserves to managed assets of 10%, minimum three-month average excess spread (by asset-backed securitization deal) of 1%, minimum equity of $684 million and a ratio of equity plus reserves to managed 90-day plus delinquencies of 2.25. As of March 31, 2002 and December 31, 2001, we were in compliance with all financial covenants under our credit agreements.

The Master Trust and the associated securitized debt provide for early amortization if certain events occur. These events are described in the applicable prospectus of each securitization transaction. The most significant events would be three consecutive months of less than zero percent excess spread or negative transferor's interest within the Master Trust. In addition, there are various triggers within our securitization agreements that, if broken, would restrict the release of cash to us from the Master Trust. This restricted cash would provide additional security to the investors of the Master Trust. The triggers are related to the performance of the Master Trust, specifically the amount of net excess spread over a one to three month period. As of March 31, 2002, we have not broken any triggers in our securitization agreements and, therefore, no cash has been restricted.



Our equity as a percent of managed assets was 9.9% as of March 31, 2002 versus 9.4% as of December 31, 2001. We have historically retained cash flow generated from earnings (versus declaring larger dividends) to provide additional equity and liquidity to fund future receivables growth. In addition, stock incentive plans provide us with a source of equity and liquidity.

Capital Adequacy

In the normal course of business, Direct Merchants Bank enters into agreements, or is subject to regulatory requirements, that result in cash, debt and dividend or other capital restrictions.

The Federal Reserve Act imposes various legal limitations on the extent to which banks can finance or otherwise supply funds to their affiliates. In particular, Direct Merchants Bank is subject to certain restrictions on any extensions of credit to or other covered transactions, such as certain purchases of assets, with MCI and its affiliates. Such restrictions limit Direct Merchants Bank's ability to lend to MCI and its affiliates. Additionally, Direct Merchants Bank is limited in its ability to declare dividends to MCI in accordance with the national bank dividend provisions.

Direct Merchants Bank is subject to certain capital adequacy guidelines adopted by the OCC. At March 31, 2002 and December 31, 2001, Direct Merchants Bank's Tier 1 risk-based capital ratio, risk-based total capital ratio and Tier 1 leverage ratio exceeded the minimum required capital levels, and Direct Merchants Bank was considered a "well-capitalized" depository institution under regulations of the OCC, as illustrated in the following table.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Direct Merchants Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Direct Merchants Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require Direct Merchants Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 leverage capital (as defined) to average assets (as defined). Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material adverse effect on our financial statements.

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Additional information about Direct Merchants Bank's actual capital amounts and ratios are presented in the following table:

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized | |
|---|---|---|---|---|---|---|
| As of March 31, 2002 | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital....... (to risk-weighted assets) | $390,623 | 18.8% | $166,273 | 8.0% | $207,841 | 10.0% |
| Tier 1 Capital...... (to risk-weighted assets) | 359,825 | 17.3% | 83,136 | 4.0% | 124,705 | 6.0% |
| Tier 1 Capital...... (to average assets) | 359,825 | 14.1% | 102,357 | 4.0% | 127,947 | 5.0% |

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized | |
|---|---|---|---|---|---|---|
| As of December 31, 2001 | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total Capital ........ (to risk-weighted assets) | $346,907 | 13.0% | $213,733 | 8.0% | $267,166 | 10.0% |
| Tier 1 Capital ....... (to risk-weighted assets) | 308,186 | 11.5% | 106,867 | 4.0% | 160,300 | 6.0% |
| Tier 1 Capital ....... (to average assets) | 308,186 | 11.2% | 110,573 | 4.0% | 138,216 | 5.0% |

FFIEC guidelines indicate that an institution with a concentration in subprime lending should hold one and one-half to three times the normal minimum capital required. The OCC has regulatory authority to evaluate the safety and soundness of Direct Merchants Bank under these more stringent guidelines. The OCC has required Direct Merchants Bank, under the more stringent guidelines, to maintain two times the normal minimum capital on those credit card loans that qualify as subprime loans (FICO score of 660 and below) and maintain a minimum capital ratio of 10%. Under these more stringent guidelines, Direct Merchants Bank's total capital ratio as of March 31, 2002 was 12.0%.

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Regulatory Matters

On April 16, 2002, Direct Merchants Bank entered into an agreement with the Office of the Comptroller of the Currency ("OCC") to strengthen the safety and soundness of Direct Merchants Bank's operations. The agreement formalizes recommendations made and requirements imposed by the OCC following an examination of Direct Merchants Bank that covered the 15-month period ended December 31, 2001. On April 17, 2002, MCI filed the agreement with the Securities and Exchange Commission as an exhibit to and incorporated by reference in a current report on Form 8-K. We filed an amendment to that current report on Form 8-K on October 22, 2002.

Direct Merchants Bank intends to comply with all of the terms of the agreement in a timely manner. Furthermore, we believe that as of the filing date of this amended Quarterly Report, Direct Merchants Bank has complied with all of the terms of the agreement, including with respect to the updating, development, adoption and delivery in a timely matter of its Strategic Plan, Capital Plan, Contingency Funding Plan and various other written action plans. Direct Merchants Bank has implemented the plans for which the OCC has posed no objection and is revising or planning to implement all others, pending and in response to comments from the OCC.

If the OCC were to conclude that Direct Merchants Bank failed to implement in a timely manner any provision of the agreement or that Direct Merchants Bank otherwise violated the agreement, the OCC could pursue various enforcement options. Under applicable provisions of the Federal Deposit Insurance Act, the OCC may, among other things, pursue an order to cease and desist from any further violations or take affirmative actions to correct conditions resulting from violations or practices, place limitations on the activities of a bank that in its opinion violated a written agreement, remove from office members of management or the board of directors of a bank or prohibit further participation by those persons in the bank's affairs, and assess civil money penalties. If any of these events were to actually occur, we could not assure you that the event would not have a material adverse affect on Direct Merchants Bank's operations or capital position.

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Forward-Looking Statements

This Quarterly Report contains some forward-looking statements. Forward-looking statements give our current expectations of future events. You will recognize these statements because they do not strictly relate to historical or current facts. Such statements may use words such as "anticipate," "estimate," "expect," "project," "intend," "think," "believe" and other words or terms of similar meaning in connection with any discussion of future performance of the Company. For example, these include statements relating to future actions, future performance of current or anticipated products, solicitation efforts, expenses, the outcome of contingencies such as litigation, and the impact of the capital markets on liquidity. From time to time, we also may provide oral or written forward-looking statements in other material released to the public.

Any or all of our forward-looking statements in this Report and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many factors, which can not be predicted with certainty, will be important in determining future results. Among such factors are higher delinquency, charge-off and bankruptcy rates of our target market of moderate-income consumers, risks associated with Direct Merchants Bank's ability to comply with its agreement with regulators regarding the safety and soundness of its operations, risks associated with our continuing ability to market our enhancement services and maintain or expand on current levels in that business, interest rate risks, risks associated with acquired portfolios, dependence on the securitization markets and other funding sources, state and federal laws and regulations that limit our business activities, product offerings and fees, privacy laws that could result in lower marketing revenue and penalties for non-compliance, and general economic conditions that can have a major impact on the performance of loans. Each of these factors and others are more fully discussed under the caption "Business--Risk Factors" contained in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2001. As a result of these factors, we cannot guarantee any forward-looking statements. Actual future results may vary materially. Also, please note that the factors we provide are those we think could cause our actual results to differ materially from expected and historical results. Other factors besides those listed here or in our 10-K/A for the year ended December 31, 2001 could also adversely affect us.

We undertake no obligations to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make on related subjects in our periodic filings with the Securities and Exchange Commission. This discussion is provided to you as permitted by the Private Securities Litigation Reform Act of 1995.

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Selected Operating Data - Managed Basis

We analyze the Company's financial performance on a managed loan portfolio basis. On a managed basis, the balance sheet and income statement includes other investors' interests in securitized loans that are not assets of the Company, thereby reversing the effects of sale accounting under SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities". We believe this information is meaningful to the reader of the financial statements. We service receivables that have been securitized and sold and own the right to the cash flows from those sold receivables in excess of interest payments due to security holders.

The following information is not in conformity with accounting principles generally accepted in the United States of America, however we believe the information is relevant to understanding the overall financial condition and results of operations of the Company.

Table 5: Managed Loan Portfolio

| (Dollars in thousands) | March 31, 2002 | % of Total | December 31, 2001 | % of Total | Mar 2 |
|---|---|---|---|---|---|
| Period-end balances: | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Credit card loans ......... | $ 2,210,847 | | $ 2,746,656 | | $1, |
| Retained interests in loans securitized .......... | 1,338,437 | | 1,263,655 | | 1, |
| Investors' interests in securitized loans accounted for as sales. | 8,223,360 | | 7,895,842 | | 6, |
| Total managed loan portfolio . | $11,772,644 | | $11,906,153 | | $9, |
| Loans contractually delinquent: | | | | | |
| 30 to 59 days .......... | 316,638 | 2.7% | 375,887 | 3.1% | |
| 60 to 89 days .......... | 256,776 | 2.2% | 274,278 | 2.3% | |
| 90 or more days ......... | 580,697 | 4.9% | 473,003 | 4.0% | |
| Total ................. | $ 1,154,111 | 9.8% | $ 1,123,168 | 9.4% | $ |

| | Three Months Ended March 31, 2002 | | 200 |
|---|---|---|---|
| Average balances: | | | |
| Credit card loans ......... | $ 2,052,596 | | $ 1,298,748 |
| Retained interes0s in loans securitized .......... | 1,835,359 | | 2,044,729 |
| Investors' interests in securitized loans accounted for as sales. | 8,074,887 | | 6,050,624 |
| Total managed loan portfolio.. | $ 11,962,842 | | $ 9,394,101 |
| Net charge offs............... | $ 384,174 | 13.0% | $ 244,969 |



The 140-basis-point increase in the managed delinquency rates over March 31, 2001 primarily reflects various factors, including a deterioration in the economy, seasoning in the loan portfolio and the impact of our 2001 credit line increase program. The credit line increase program added pressure to some of our customers due to increased average outstanding balances, which require higher monthly payments. This, along with a deteriorating economy, has made our collections efforts more difficult, resulting in higher delinquencies. The increase in charge off ratios for the three-month period ended March 31, 2002 primarily reflects a slow down in loan growth, deterioration in the economy and the 2001 credit line increase program.

The amount of customer receivables in forbearance programs was $775.1 million or 7% of total managed loans as of March 31, 2002 compared with $837.0 million or 7% of managed loans as of December 31, 2001. All delinquent receivables in forbearance programs are included in Table 5.

Net Interest Income

Table 6: Analysis of Average Balances, Interest and Average Yields and Rates

| (Dollars in thousands) | Three Months Ended March 31, 2002 Average Balance | Interest | Yield/ Rate | Average Balance |
|---|---|---|---|---|
| Credit card loans ............. | $11,962,842 | $ 525,360 | 17.8% | $ 9,394,101 |
| Total interest-earning assets.. | 12,262,900 | 526,678 | 17.4% | 9,839,055 |
| Total interest-bearing liabilities ................ | 10,360,913 | 88,404 | 3.5% | 8,542,037 |
| Net interest income and interest margin (1) ........ | -- | $ 438,274 | 14.5% | -- |
| Net interest rate spread (2)... | -- | -- | 13.9% | -- |
| Return on average assets ...... | -- | -- | 1.8% | -- |
| Return on average total equity ..................... | -- | -- | 18.4% | -- |

(1) We compute net interest margin by dividing annualized net interest income by average total interest-earning assets.

(2) The net interest rate spread is the annualized yield on average interest-earning assets minus the annualized funding rate on average interest-bearing liabilities.

Net interest income consists primarily of interest earned on our credit card loans, less interest expense on borrowings to fund the loans. Managed net interest income for the three months ended March 31, 2002 was $438.3 million compared to $326.5 million for the same period in 2001. The increase in net interest income is primarily due to a $2.4 billion increase in managed average interest-earning assets and increases in net interest margin to 14.5% for the three months ended March 31, 2002, compared to 13.5% for the same period in 2001. The managed net interest margin increase is primarily due to lower cost of funds offset by lower portfolio yield.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss from adverse changes in market prices and rates. Our principal market risk is due to changes in interest rates. This affects us directly in our lending and borrowing activities, as well as indirectly, as interest rates may impact the payment performance of our cardholders.

To manage our direct risk to market interest rates, management actively monitors the interest rates and the interest sensitive components of our owned and managed balance sheet to minimize the impact changes in interest rates have on the fair value of assets, net income and cash flow. We seek to minimize the impact of changes in interest rates on us primarily by matching asset and liability repricings.

Our primary managed assets are credit card loans, which are virtually all priced at rates indexed to the variable Prime Rate. We fund credit card loans through a combination of cash flows from operations, asset securitizations, bank loans, subsidiary bank deposits, long-term debt and equity issuances. Our securitized loans are owned by a trust and bank-sponsored single-seller and multi-seller receivable conduits, which have committed funding primarily indexed to variable commercial paper rates and LIBOR. The $270 million bank credit facility has pricing that is also indexed to LIBOR and Prime Rate. The subsidiary bank deposits and long-term debt are issued at fixed interest rates. At March 31, 2002 approximately 8.8% of the trust and conduit funding of securitized receivables was funded with fixed rate securities. As of April 22, 2002, we had no fixed rate trust or conduit funding of securitized receivables.

In an interest rate environment with rates at or below current rates, 91.2% of the securitization funding for the managed loan portfolio is indexed to floating commercial paper and LIBOR rates. In an interest rate environment with rates significantly above current rates, the potentially negative impact on earnings of higher interest expense is mitigated by fixed rate funding and interest rate cap contracts.

The approach we use to quantify interest rate risk is a sensitivity analysis, which we believe best reflects the risk inherent in our business. This approach calculates the impact on net income from an instantaneous and sustained change in interest rates by 200 basis points. Assuming that we take no counteractive measures, as of March 31, 2002, a 200 basis point increase in interest rates affecting our floating rate financial instruments, including both debt obligations and loans, will result in an increase in net income of approximately $78 million relative to a base case over the next 12 months compared to an approximate $20 million increase as of December 31, 2001. A decrease of 200 basis points will result in a reduction in net income of approximately $59 million as of March 31, 2002, compared to a $2 million reduction as of December 31, 2001. The increased sensitivity to interest rate fluctuation as of March 31, 2002 is due to a repricing on our credit card portfolio implemented in first quarter of 2002. You should not construe our use of this methodology to quantify the market risk of financial instruments as an endorsement of its accuracy or the accuracy of the related assumptions. In addition, this methodology does not take into account the indirect impact interest rates may have on the payment performance of our cardholders. The quantitative information about market risk is necessarily limited because it does not take into account operating transactions or other costs associated with managing immediate changes in interest rates.

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## Part II. Other Information

### Item 1. Legal Proceedings

We are a party to various legal proceedings resulting from the ordinary business activities relating to our operations. In July 2000 an Amended Complaint was filed in Hennepin County District Court in Minneapolis, Minnesota against MCI and our subsidiaries Metris Direct, Inc. and Direct Merchants Bank. The complaint seeks damages in unascertained amounts and purports to be a class action complaint on behalf of all credit card accountholders who were issued a credit card by Direct Merchants Bank and were allegedly assessed fees or charges that the cardholder did not authorize. Specifically, the complaint alleges violations of the Minnesota Prevention of Consumer Fraud Act, the Minnesota

Deceptive Trade Practices Act and breach of contract. A final settlement approval hearing was held on May 30, 2002, and the Court signed the order granting final approval of the settlement whereby we will pay approximately $5.6 million for attorneys' fees and costs incurred by attorneys for the plaintiffs in separate lawsuits filed in Arizona, California and Minnesota in 2000 and 2001. Under the terms of the settlement we denied any wrongdoing or liability. The time for filing an appeal expired on August 5, 2002, and no appeal was filed. At this time, we are in the process of implementing the terms of the settlement.

On May 3, 2001, Direct Merchants Bank entered into a consent order with the OCC. The consent order required Direct Merchants Bank to pay approximately $3.2 million in restitution to approximately 62,000 credit card accountholders who applied for and received a credit card in connection with a series of limited test marketing campaigns from March 1999 to June 2000. Under the terms of the consent order, Direct Merchants Bank made no admission or agreement on the merits of the OCC's assertions. The restitution as required by the OCC consent order was paid and is reflected in our December 31, 2001 financial statements. We believe that Direct Merchants Bank's agreement with the OCC will not have a material adverse affect on the financial position of MCI or Direct Merchants Bank.

In May 2001, the OCC also indicated that it was considering whether to assess civil money penalties against Direct Merchants Bank. On October 17, 2002, the OCC notified Direct Merchants Bank that it will not assess civil money penalties.

On April 16, 2002, Direct Merchants Bank entered into an agreement with the OCC to strengthen the safety and soundness of Direct Merchants Bank's operations. For further information, see "Regulatory Matters" on page 32 of this Report.

Item 2. Changes in Securities
Not applicable

Item 3. Defaults Upon Senior Securities
Not applicable

Item 4. Submission of Matters to a Vote of Security Holders
Not applicable



Item 5. Other Information
Not applicable

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

11 Computation of Earnings Per Share.

99.1 Agreement between Direct Merchants Credit Card Bank, N.A. and the Office of the Comptroller of the Currency, dated April 16, 2002 (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated April 17, 2002 (File No. 1-12351)).

99.2 Certification of Principal Executive Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

99.3 Certification of Principal Financial Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.

(b) Reports on Form 8-K: On April 17, 2002, we filed a Current Report on Form 8-K to report that our wholly-owned subsidiary, Direct Merchants Credit Card Bank, N.A., had entered into an agreement on April 16, 2002 with the Office of the Comptroller of the Currency, the agency that regulates the Bank, to strengthen certain aspects of the safety and soundness of the Bank's operations. We filed an amendment to that current report on Form 8-K on October 22, 2002. See "Regulatory Matters" on page 32 of this report.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

METRIS COMPANIES INC.
(Registrant)

Date: October 22, 2002 By: /s/ David D. Wesselink