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

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

FORM 10-K/A

AMENDMENT NO. 1

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

For the fiscal year ended  
December 31, 2001

001-12351  
Commission file number  
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METRIS COMPANIES INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State of Incorporation)

41-1849591  
(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)

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$.01 Par Value

Securities registered pursuant to Section 12(g) of the Act: None

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 and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment to this Form 10-K/A.

As of March 15, 2002, 62,225,770 shares of the Registrant's Common Stock were outstanding and the aggregate market value of common stock held by non-affiliates of the Registrant on that date was approximately \$1,448,927,016 based upon the closing price on the New York Stock Exchange on March 15, 2002.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the Proxy Statement for the Annual Meeting of Shareholders of Metris Companies Inc. held on May 7, 2002, which was filed with the Securities and Exchange Commission within 120 days after December 31, 2001, are incorporated by reference in Part III.

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PART I

## Edgar Filing: METRIS COMPANIES INC - Form 10-K/A

### Item 1. Business

Metris Companies Inc. ("MCI") and its subsidiaries, which may be referred to as "we," "us," "our," and the "Company," is one of the nation's leading providers of financial services products and services. The company issues credit cards through its wholly owned subsidiary, Direct Merchants Credit Card Bank, National Association ("Direct Merchants Bank"), the 10th largest bankcard issuer in the United States. As a top-tier enhancement services company, MCI also offers consumers a variety of products, including credit card protection and insurance, extended service plans and membership clubs. Our credit card customers and prospects include individuals for whom credit bureau information is available ("external prospects") and persons identified through other third-party sources including customer lists and databases. We market our enhancement services, including debt waiver programs, membership clubs, extended service plans and third-party insurance to our credit card customers, customers of third parties and the broad market.

MCI was incorporated in Delaware on August 20, 1996, and completed an initial public offering in October 1996. Our principal subsidiaries are Direct Merchants Bank, Metris Direct, Inc. and Metris Receivables, Inc.

#### Business Segments

We measure performance and operate in two business segments:

- o Consumer Lending Products, which are primarily unsecured and partially secured credit cards issued by Direct Merchants Bank; and
- o Enhancement Services, which include credit protection, membership clubs, extended service plans and third-party insurance offered to our credit card customers, customers of third parties and the broad market.

We generate income from our consumer lending products through:

- o interest and other finance charges assessed on outstanding credit card loans;
- o credit card fees (including annual membership, cash advances, overlimit fees, and late fees);
- o interchange fees; and
- o collections and sales on recovery assets.

The primary expenses of this business are:

- o the costs of funding the loans;
- o provisions for loan losses and operating expenses, including employee compensation, account solicitation and marketing expenses; and
- o data processing and servicing expenses.

Profitability is affected by:

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- o response and approval rates to solicitation efforts;
- o loan growth;
- o interest spreads on loans;
- o credit card usage;
- o credit quality (delinquencies and charge-offs);
- o card cancellations; and
- o fraud losses.

Our consumer lending business primarily targets moderate-income consumers who we believe have historically been overlooked by other credit card companies. We target and evaluate prospective customers in this market by using our proprietary scoring techniques, together with information from credit bureaus and other customer lists and databases, to determine a potential customer's creditworthiness. We also use sophisticated modeling techniques to evaluate the expected risk, responsiveness and profitability of each prospective customer and to offer and price the products and services we believe to be appropriate for each customer. (See more detailed discussion following under the caption "Business Lines" on pages 5 through 18 of this Report.)

In addition to sales to third parties, the enhancement services business derives benefits from our consumer lending business because we cross-sell these services to our credit cardholders. Nonetheless, our two business segments are different with respect to the factors that affect profitability, including how income is generated and how expenses are incurred. These differences require us to manage our operations separately.

We receive revenue from our enhancement services through fees for those services.

Expenses include costs of:

- o solicitation;
- o underwriting and claims servicing expenses;
- o fees paid to third parties; and
- o other operating expenses.

The primary factors that affect profitability for this business are:

- o response rates to solicitation efforts;
- o returns or cancel rates;
- o renewal rates; and
- o claims rates.

### Strategy

The principal components of our strategy are the following:

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Identify and solicit additional external prospects for credit cards

We intend to continue adding credit card accounts through the use of our own internally developed risk models. We have developed our own proprietary credit risk modeling system. By incorporating individual credit information from the major credit bureaus into this proprietary modeling system, we expect to generate additional customer relationships from external prospects.

Use risk-based pricing

We determine the specific pricing for an individual's credit card offer through the prospective customer's risk profile and expected responsiveness prior to solicitation and continually monitor and adjust pricing as the relationship continues, a practice known as "risk-based pricing." We believe the use of risk-based pricing allows us to maximize the profitability of a customer relationship.

Pursue acquisitions of credit card portfolios or businesses

We pursue acquisitions of credit card portfolios or businesses whose customers fit our product and target market profile or which otherwise strategically fit with our business.

Increase the number of third-party customers using our products and services

We seek to access additional customers for our products and services by establishing relationships with third parties. Our strategy is to continue to use our proprietary risk, response and profitability models to solicit strategic partners' customers for credit cards and to focus our cross-selling activities in order to increase the volume of enhancement services products purchased by these customers.

Sell multiple products and services to each customer

We intend to use interactions with our customers to sell additional products, thereby leveraging our account acquisition costs and infrastructure. Currently, we focus our efforts on selling enhancement services to our credit card customers and customers of third parties.

Diversify product offerings to our customers

We segment markets to expand the success of our existing consumer lending products and enhancement services. We analyze the data in our proprietary database and the databases of others to determine the needs of our target markets. Then we develop, test and effectively market these new products to our target markets.

### Business Lines

We operate through two businesses: consumer lending products and enhancement services.

Consumer Lending Products

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### Products

Our consumer lending products are primarily unsecured and partially secured credit cards, including the Direct Merchants Bank MasterCard(R) and Visa(R). We offer co-branded credit cards and may also offer other consumer lending products either directly or through alliances with other companies. At December 31, 2001, we had approximately 4.9 million credit card accounts with approximately \$11.9 billion in managed credit card receivables. According to the Nilson Report, at December 31, 2001, we were the 9th largest MasterCard(R) issuer in the United States based on the number of cards issued, and the 10th largest bankcard issuer based on managed credit card loan balances.

### Prospects

Our primary sources of prospects to solicit for credit card offers are obtained from credit bureau queries and individuals in third-party customer lists and databases. Currently, our most significant source is the leads obtained from credit bureau inquiries.

### Credit Scoring

We use internally and externally developed proprietary models to enhance our evaluation of prospects. These models help segment prospects into narrower ranges within each risk score provided by Fair, Isaac and Co. ("FICO"), allowing us to better evaluate individual credit risk and to tailor our risk-based pricing accordingly. We also use this segmentation to exclude certain individuals from our marketing solicitations.

We generate external prospects from lists obtained from the major credit bureaus based on criteria established by us as well as from other third-party sources. We use proprietary models and additional analysis in conjunction with the files obtained from credit bureaus to further segment prospects based upon their likelihood of default.

We believe our methods are effective in further segmenting and evaluating risk within risk score bands. We have and continue to use the results of our analysis of prospects to adjust the proprietary models to determine the pricing for various segments and to exclude certain segments from subsequent direct marketing efforts. While we believe that the proprietary models and additional analysis are valuable tools in analyzing relative risks, it is not possible to accurately predict which consumers will default or the overall level of defaults.

We believe that both the proprietary models and our internal credit score give us a competitive advantage in evaluating the credit risk of moderate-income consumers and thereby broaden our customer prospect base. After every marketing campaign, we monitor the performance of the proprietary models and continually re-evaluate the effectiveness of these models in segmenting credit risk, resulting in further refinements to our selection criteria for prospects. Over time, we believe that we will capture additional credit information on the behavioral characteristics of prospects which will allow us to further increase the effectiveness of our proprietary models.

### Solicitation

Prospects for solicitation include both external prospects and customers of

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third parties. We contact prospects on a nationwide basis primarily through pre-screened direct mail, invitation to apply and telephone solicitations. We receive responses to our solicitations, perform fraud screening, verify name and address changes, and obtain any information which may be missing from the application. We then make the credit decisions and approve, deny or begin the exception processing. We process exceptions for, among other things, derogatory credit bureau information and fraud warnings. Our credit analysts process exception applications based on policies approved by our credit policy committee.

Pricing

Through risk-based pricing, we price credit card offers based upon a prospect's risk profile prior to solicitation or upon receipt of an application. We evaluate a prospect to determine credit needs, credit risk and existing credit availability, and then develop a customized offer that includes the most appropriate product, brand, pricing and credit line. We have numerous pricing structures on our credit card products. After credit card accounts are opened, we periodically monitor customers' internal and external credit performance and recalculate delinquency, profitability, attrition and bankruptcy predictors. As customers evolve through the credit life cycle and are regularly rescored, the lending relationship may evolve to include more or less restrictive pricing and product configurations.

Age of Portfolio

The following tables set forth, as of December 31, 2001 and 2000, the number of credit card accounts and the amount of outstanding loans based on the age of the owned accounts. (Accounts in acquired portfolios are presented based on when the account was originated with the previous issuer.)

(Dollars in thousands)  
2001

Age Since Origination -----	Number of Accounts -----	Percentage of Accounts -----	Loans Outstanding -----	Percentage of Loans Outstanding -----
0-6 Months .....	419,586	21.2%	\$ 327,733	11.9%
7-12 Months .....	269,831	13.7%	478,649	17.4%
13-18 Months .....	297,057	15.0%	496,114	18.1%
19-24 Months .....	324,656	16.4%	534,486	19.5%
25-36 Months .....	145,054	7.3%	223,041	8.1%
37+ Months .....	521,171	26.4%	686,633	25.0%
	-----	-----	-----	-----
Total .....	1,977,355	100.0%	\$2,746,656	100.0%
	=====	=====	=====	=====

2000

Age Since	Number	Percentage	Loans	Percentage of Loans
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Origination -----	of Accounts -----	of Accounts -----	Outstanding -----	Outstanding -----
0-6 Months .....	482,344	26.1%	\$ 184,238	15.6%
7-12 Months .....	456,199	24.7%	270,136	22.9%
13-18 Months .....	75,137	4.1%	39,460	3.4%
19-24 Months .....	17,763	1.0%	5,777	0.5%
25-36 Months .....	62,658	3.4%	48,681	4.1%
37+ Months .....	750,572	40.7%	630,911	53.5%
	-----	-----	-----	-----
Total .....	1,844,673	100.0%	\$1,179,203	100.0%
	=====	=====	=====	=====

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The following tables set forth, as of December 31, 2001 and 2000, the number of credit card accounts and the amount of outstanding loans based on the age of the managed accounts (includes investors' interests in securitized loans). (Accounts in acquired portfolios are presented based on when the account was originated with the previous issuer.)

(Dollars in thousands)  
2001

Age Since Origination -----	Number of Accounts -----	Percentage of Accounts -----	Loans Outstanding -----	Percentage of Loans Outstanding -----
0-6 Months .....	587,942	11.9%	\$ 576,621	4.8%
7-12 Months .....	466,773	9.5%	756,112	6.4%
13-18 Months .....	552,678	11.2%	976,050	8.2%
19-24 Months .....	547,183	11.1%	1,160,980	9.8%
25-36 Months .....	613,626	12.5%	1,767,649	14.8%
37+ Months .....	2,161,177	43.8%	6,668,741	56.0%
	-----	-----	-----	-----
Total .....	4,929,379	100.0%	\$11,906,153	100.0%
	=====	=====	=====	=====

2000

Age Since Origination -----	Number of Accounts -----	Percentage of Accounts -----	Loans Outstanding -----	Percentage of Loans Outstanding -----
0-6 Months .....	754,748	16.9%	\$ 626,709	6.8%
7-12 Months .....	700,055	15.7%	843,396	9.1%
13-18 Months .....	456,801	10.2%	819,667	8.8%
19-24 Months .....	252,058	5.6%	521,530	5.6%
25-36 Months .....	596,358	13.4%	1,672,647	18.0%
37+ Months .....	1,703,962	38.2%	4,789,159	51.7%
	-----	-----	-----	-----
Total .....	4,463,982	100.0%	\$9,273,108	100.0%
	=====	=====	=====	=====



## Geographic Distribution

We solicit credit card customers on a national basis and, therefore, maintain a geographically diversified portfolio. The following tables show the distribution of managed accounts and amount of managed outstanding loans by state, as of December 31, 2001 and 2000.

(Dollars in thousands)

State	Number of Accounts	Percentage of Accounts	Loans Outstanding	Percentage of Loans Outstanding
California .....	684,964	13.9%	\$ 1,487,384	12.5%
New York .....	426,585	8.7%	1,001,146	8.4%
Texas .....	407,072	8.3%	963,379	8.1%
Florida .....	354,529	7.2%	866,722	7.3%
Illinois .....	210,230	4.3%	493,124	4.1%
Ohio .....	186,421	3.8%	483,621	4.1%
Pennsylvania .....	161,812	3.3%	407,574	3.4%
New Jersey .....	156,847	3.2%	354,337	3.0%
Michigan .....	135,341	2.7%	338,404	2.8%
Georgia .....	123,223	2.5%	320,815	2.7%
Virginia .....	122,899	2.5%	313,126	2.6%
All others (1) .....	1,959,456	39.6%	4,876,521	41.0%
Total .....	4,929,379	100.0%	\$11,906,153	100.0%

State	Number of Accounts	Percentage of Accounts	Loans Outstanding	Percentage of Loans Outstanding
California .....	607,333	13.6%	\$1,170,856	12.6%
Texas .....	382,037	8.6%	789,888	8.5%
New York .....	373,952	8.4%	755,207	8.1%
Florida .....	325,352	7.3%	690,960	7.5%
Ohio .....	170,282	3.8%	375,759	4.1%
Illinois .....	180,612	4.0%	371,976	4.0%
Pennsylvania .....	142,140	3.2%	303,338	3.3%
Michigan .....	120,718	2.7%	257,569	2.8%
New Jersey .....	131,746	3.0%	254,643	2.7%
Georgia .....	116,016	2.6%	250,599	2.7%
Virginia .....	114,050	2.6%	245,829	2.7%
North Carolina .....	109,858	2.5%	231,943	2.5%
All others (1) .....	1,689,886	37.7%	3,574,541	38.5%
Total .....	4,463,982	100.0%	\$9,273,108	100.0%

(1) No other state accounts for more than 2.5% of loans outstanding.

## Credit Lines

Once we approve an account, we use automated screening and credit scoring techniques to establish an initial credit line based on the individual's risk profile. We may elect, at any time and without prior notice to a cardholder, to

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prevent or restrict further credit card use by the cardholder, usually as a result of poor payment

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performance or our concern over the creditworthiness of the cardholder. We manage credit lines based on the results of the behavioral scoring analysis, and in accordance with our internally established criteria. These analytic models automatically and regularly assign credit line increases and decreases to individual customers, as well as determine the systematic collection steps to be taken at the various stages of delinquency. We use these models to manage the authorization of each transaction, as well as the collections strategies used for non-delinquent accounts with balances above their assigned credit lines.

The following tables set forth information with respect to credit limit and account balance ranges of our owned credit card loan portfolio, as of December 31, 2001 and 2000.

(Dollars in thousands)

2001

Credit Limit Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
\$1,000 or Less .	285,573	\$ 125,578	4.6%	\$ 65,236	65.8%
\$1,001-\$2,000 ..	300,827	253,301	9.2%	234,328	51.9%
\$2,001-\$3,500 ..	392,914	471,482	17.2%	664,365	41.5%
\$3,501-\$5,000 ..	330,690	506,166	18.4%	943,968	34.9%
\$5,001-\$10,000 .	511,596	930,876	33.9%	2,896,001	24.3%
Over \$10,000 ...	155,755	459,253	16.7%	1,493,769	23.5%
Total .....	1,977,355	\$2,746,656	100.0%	\$6,297,667	30.4%

2000

Credit Limit Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
\$1,000 or Less .	478,380	\$ 106,030	9.0%	\$ 75,326	58.5%
\$1,001-\$2,000 ..	261,838	119,426	10.1%	190,560	38.5%
\$2,001-\$3,500 ..	309,578	207,424	17.6%	490,915	29.7%
\$3,501-\$5,000 ..	217,586	177,141	15.0%	609,388	22.5%
\$5,001-\$10,000 .	420,298	364,862	31.0%	2,529,364	12.6%
Over \$10,000 ...	156,993	204,320	17.3%	1,556,756	11.6%
Total .....	1,844,673	\$1,179,203	100.0%	\$5,452,309	17.8%

2001

Account Balance Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
Credit Balance .	23,973	\$ (2,370)	(0.1%)	\$ 79,986	(3.1%)

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No Balance .....	667,750	--	--	3,548,784	--
\$1,000 or Less .	542,734	251,743	9.2%	1,398,772	15.3%
\$1,001-\$2,000 ..	267,326	406,266	14.8%	474,256	46.1%
\$2,001-\$3,500 ..	231,103	644,837	23.5%	388,647	62.4%
\$3,501-\$5,000 ..	124,025	538,151	19.6%	211,318	71.8%
\$5,001-\$10,000 .	107,181	743,293	27.0%	183,097	80.2%
Over \$10,000 ...	13,263	164,736	6.0%	12,807	92.8%
	-----	-----	-----	-----	-----
Total .....	1,977,355	\$ 2,746,656	100.0%	\$ 6,297,667	30.4%
	=====	=====	=====	=====	=====

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2000

Account Balance Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
-----	-----	-----	-----	-----	-----
Credit Balance.	23,496	\$ (1,164)	(0.1%)	\$ 81,962	(1.4%)
No Balance ...	558,907	--	--	3,263,100	--
\$1,000 or Less.	660,218	157,506	13.4%	1,114,966	12.4%
\$1,001-\$2,000 .	230,537	177,258	15.0%	364,141	32.7%
\$2,001-\$3,500 .	185,463	259,997	22.1%	291,274	47.2%
\$3,501-\$5,000 .	86,095	188,517	16.0%	162,524	53.7%
\$5,001-\$10,000	86,319	310,644	26.3%	158,001	66.3%
Over \$10,000 ..	13,638	86,445	7.3%	16,341	84.1%
	-----	-----	-----	-----	-----
Total ....	1,844,673	\$ 1,179,203	100.0%	\$ 5,452,309	17.8%
	=====	=====	=====	=====	=====

The following tables set forth information with respect to credit limit and account balance ranges of our managed loan portfolio (includes investors' interests in loans securitized), as of December 31, 2001 and 2000.

(Dollars in thousands)

2001

Credit Limit Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
-----	-----	-----	-----	-----	-----
\$1,000 or Less.	480,909	\$ 275,322	2.3%	\$ 102,657	72.8%
\$1,001-\$2,000 .	566,593	558,262	4.7%	396,326	58.5%
\$2,001-\$3,500 .	774,180	1,097,179	9.2%	1,123,276	49.4%
\$3,501-\$5,000 .	768,475	1,439,888	12.1%	1,882,893	43.3%
\$5,001-\$10,000.	1,585,518	4,508,918	37.9%	6,959,736	39.3%
Over \$10,000 ..	753,704	4,026,584	33.8%	5,213,070	43.6%
	-----	-----	-----	-----	-----
Total ....	4,929,379	\$11,906,153	100.0%	\$15,677,958	43.2%
	=====	=====	=====	=====	=====

2000

Credit Limit Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
-----	-----	-----	-----	-----	-----
\$1,000 or Less.	742,667	\$ 386,865	4.2%	\$ 116,715	76.8%
\$1,001-\$2,000 .	614,746	673,919	7.2%	356,481	65.4%

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\$2,001-\$3,500 .	804,028	1,323,157	14.3%	988,615	57.2%
\$3,501-\$5,000 .	731,754	1,698,768	18.3%	1,536,701	52.5%
\$5,001-\$10,000.	1,405,708	4,636,867	50.0%	5,872,441	44.1%
Over \$10,000 ..	165,079	553,532	6.0%	1,986,399	21.8%
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Total ....	4,463,982	\$ 9,273,108	100.0%	\$10,857,352	46.1%
	=====	=====	=====	=====	=====

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(Dollars in thousands)  
2001

Account Balance Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
-----	-----	-----	-----	-----	-----
Credit Balance .	58,543	\$ (5,782)	(0.1%)	\$ 242,223	(2.4%)
No Balance .....	1,256,609	--	--	6,873,759	--
\$1,000 or Less .	1,021,506	445,748	3.8%	3,399,472	11.6%
\$1,001-\$2,000 ..	602,868	895,632	7.5%	1,349,978	39.9%
\$2,001-\$3,500 ..	643,048	1,751,345	14.7%	1,382,679	55.9%
\$3,501-\$5,000 ..	464,559	1,962,426	16.5%	998,741	66.3%
\$5,001-\$10,000 .	728,695	5,063,594	42.5%	1,310,997	79.4%
Over \$10,000 ...	153,551	1,793,190	15.1%	120,109	93.7%
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Total .....	4,929,379	\$ 11,906,153	100.0%	\$15,677,958	43.2%
	=====	=====	=====	=====	=====

2000

Account Balance Range	Number of Accounts	Loans Outstanding	Percentage of Loans Outstanding	Open to Buy	Percentage Utilized
-----	-----	-----	-----	-----	-----
Credit Balance.	60,809	\$ (6,345)	(0.1%)	\$ 208,754	(3.1%)
No Balance .....	854,604	--	--	4,926,960	--
\$1,000 or Less.	1,232,581	571,426	6.2%	2,704,744	17.4%
\$1,001-\$2,000 ..	631,019	978,220	10.5%	1,016,205	49.0%
\$2,001-\$3,500 ..	673,321	1,890,114	20.4%	939,575	66.8%
\$3,501-\$5,000 ..	460,109	1,996,404	21.5%	579,606	77.5%
\$5,001-\$10,000..	536,680	3,612,067	39.0%	459,380	88.7%
Over \$10,000 ...	14,859	231,222	2.5%	22,128	91.3%
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Total ....	4,463,982	\$ 9,273,108	100.0%	\$ 10,857,352	46.1%
	=====	=====	=====	=====	=====

Since the start of our Broker CD program in 1999 we have distributed, on a random basis, organically generated customer accounts between the owned portfolio and accounts included in the Master Trust with the goal of maintaining a balanced funding mix between bank deposits/conduits and our Master Trust. Also, acquired portfolios, as well as our partially secured card and partner programs, were generally included in the owned credit card portfolio. As a result, the age of our receivables on an owned basis is younger than on a managed basis. On an owned basis, the percentage of accounts and percentage of outstanding balances greater than two years since origination as of December 31, 2001 were 33.7% and 33.1% versus 56.3% and 70.8% on a managed basis. In 2000 the percentage of accounts and percentage of outstanding balance on the owned

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portfolio greater than two years since origination were 44.1% and 57.6% versus 51.6% and 69.7% on a managed basis.

As of December 31, 2001 on an owned basis, 16.7% of the outstanding receivable balance relates to accountholders with credit limits in excess of \$10,000 as compared to 33.8% on a managed basis. On an owned portfolio basis, 50.6% was outstanding to accountholders with credit limits in excess of \$5,000, compared to 71.7% on a managed basis. As of December 31, 2000 on an owned basis, 17.3% of the outstanding receivable balance relates to accountholders with credit limits in excess of \$10,000 as compared to 6.0% on a managed basis. On an owned basis 48.3% of the credit card portfolio was outstanding to accountholders with credit limits in excess of \$5,000, compared to 56.0% on a managed basis. The difference in the distributions between the owned and managed portfolios primarily reflects the generally younger accounts that are in the owned portfolio.

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The banking regulators have issued guidelines to further segregate a credit card issuers loan portfolio between sub-prime loans (loans to consumers who have a FICO credit score of 660 or less) and prime loans (loans to consumers with FICO scores in excess of 660). The bank regulators deem sub-prime loans to have higher credit risk, and therefore require higher levels of capital and allowance for loan losses. Sub-prime receivables on an owned basis were \$1.5 billion or 54% of the owned portfolio as of December 31, 2001, compared to \$1.2 billion or 98% of the owned portfolio as of December 31, 2000. The amount of sub-prime receivables on a managed basis was \$6.9 billion or 58% of the managed portfolio as of December 31, 2001, compared to \$5.2 billion or 56% of the managed portfolio as of December 31, 2000.

Overall, the Company believes that the credit quality in the owned credit card portfolio is generally similar to the managed portfolio. Delinquent loans for the owned portfolio were 10.1% and 7.6% as of December 31, 2001 and 2000, versus 9.4% and 8.3% on a managed basis. Net principal charge-offs in the owned credit card portfolio were 14.5% and 23.5% for the years ended December 31, 2001 and 2000, versus 11.0% and 9.7% on a managed basis. The higher level of sub-prime loans on an owned basis as of December 31, 2000 reflects the Company's partially secured card program, which was discontinued in early 2001. The higher level of owned charge-offs in both 2001 and 2000 are also principally due to the partially secured card program.

During 2000 and 2001, the Company completed an industry competitive analysis which indicated that our credit limits to our customers were significantly below those offered by our competitors to comparable customers. The average account balance as of December 31, 2001 was \$1,389 on an owned basis and \$2,415 on a managed basis, and the average account balance as of December 31, 2000 was \$639 on an owned basis and \$2,077 on a managed basis.

### Servicing, Billing and Payment

We have established a relationship with First Data Resources, Inc. ("FDR") for cardholder processing services. FDR is a subsidiary of First Data Corporation, a provider of information processing and related services, including cardholder processing (services for financial institutions which issue credit cards to cardholders), and merchant processing (services for financial institutions which make arrangements with merchants for the acceptance of credit cards as methods of payment). FDR provides the following services for us:

- o data processing;

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- o credit card reissuance;
- o monthly statements; and
- o interbank settlement.

Our processing services agreement with FDR expires in 2011. We handle the following functions internally:

- o applications processing; and
- o back office support for mail inquiries and fraud management.

In addition, we handle most inbound customer service telephone calls for our customer base.

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We generally assess periodic finance charges on an account if the cardholder has not paid the balance in full from the previous billing cycle. We base these finance charges on the average daily balance outstanding on the account during the monthly billing cycle.

If we are not paid in full prior to the due date, which is generally 25 days after the statement cycle date and applicable grace period, we impose finance charges on all purchases from the date of the transaction to the statement cycle date. We also impose finance charges on each cash advance from the day we make the advance until the cardholder pays the advance in full. We apply finance charges to the average daily balance. We do not impose a finance charge on purchases if cardholders pay the entire balance on the account by the due date.

We assess an annual fee on some credit card accounts. We may waive the annual fee, or a portion thereof, in connection with the solicitation of new accounts depending on the credit terms offered, which we determined based on the prospect's risk profile prior to solicitation, or when we determine a waiver to be appropriate considering the account's overall profitability. In addition to the annual fee, we charge accounts other fees, including:

- o a late fee with respect to any unpaid monthly balance if we do not receive the required minimum monthly payment by the due date;
- o a cash advance fee for each cash advance;
- o a fee with respect to each check submitted by a cardholder in payment of an account, which the cardholder's bank does not honor;
- o an overlimit charge if, at any time during the billing cycle, the total amount owed exceeds the cardholder's credit line by an amount consistent with the cardholder agreement; and
- o card processing or application fees for some credit card offers.

Each cardholder is subject to an agreement governing the terms and conditions of their account. Pursuant to the agreement, we reserve the right to change or terminate certain terms, conditions, services and features of the account (including periodic finance charges, late fees, returned check charges and any other charges, or the minimum payment), subject to the conditions set forth in the cardholder agreement.

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FDR sends monthly billing statements to cardholders on our behalf. When we establish an account, we assign a billing cycle to it. Each of these cycles has a separate monthly billing date based on the business day of the calendar month on which the cycle begins. Each month, we send a statement to all accounts with an outstanding balance greater than \$1. All cardholders with open accounts must make a minimum monthly payment, generally the greater of: \$15, 2.5% of the outstanding balance, the finance charge or the balance of the account if the balance is less than \$15, plus any past due amount. If we do not receive the minimum payment by the due date, we consider the account delinquent.

Most merchant transactions by cardholders are authorized online. The remaining transactions generally are low dollar amounts, typically below \$50. All authorizations are handled through FDR's adaptive control and fraud detection systems.

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### Delinquency, Collections and Charge-offs

We consider an account delinquent if we do not receive a payment due within 25 days from the closing date of the statement. Once an account becomes delinquent, the equivalent of three minimum payments must be received before we re-age the account to current. We handle collections internally, and we determine the appropriate collection action to take by using the adaptive control system, which continually monitors all delinquent accounts. We close accounts that become 60 days contractually delinquent, but do not necessarily charge them off. We charge off and take accounts as a loss either:

- o within 60 days after formal notification of bankruptcy;
- o at the end of the month during which most unsecured accounts become contractually 180 days past due; or
- o at the end of the month during which unsecured accounts that have entered into a credit counseling or other similar program and later become contractually 120 days past due and at the end of the month during which partially secured accounts become contractually 120 days past due.

We immediately reserve for and charge off accounts that we identify as fraud losses no later than 90 days after the last activity. We refer charged-off accounts to our recovery unit for coordination of collection efforts to recover the amounts owed. When appropriate, we place accounts with external collection agencies or attorneys. Periodically, we sell a portion of our charged-off portfolio to third parties.

### Asset Securitizations and Other Funding Vehicles

Our securitizations involve packaging and selling pools of both current and future receivable balances on credit card accounts, in which we retain the servicing of such receivables. Our securitizations are treated either as sales or collateralized borrowing agreements under accounting principles generally accepted in the United States of America. The securitized receivables accounted for as sales are removed from our balance sheet and treated as managed loans.

We primarily securitize receivables by selling the receivables either to our proprietary trust, the Metris Master Trust, or to bank-sponsored single-seller and multi-seller commercial paper conduits.

### The Metris Master Trust

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The Metris Master Trust ("Master Trust") was formed in May 1995 pursuant to a pooling and servicing agreement, as amended. Metris Receivables, Inc. ("MRI"), one of our subsidiaries, transfers receivables in designated accounts to the Master Trust in exchange for proceeds and an interest in the Master Trust. MRI may then exchange portions of this interest for one or more series of securities which it may then sell publicly or privately to third-party investors. The securities each represent undivided interests in all of the receivables in the Master Trust, and may be split into separate classes which have different terms. The different classes of an individual series are structured to obtain specific credit ratings. As of December 31, 2001, 15 series of publicly issued securities were outstanding. We currently retain the most subordinated class of securities in each series and sell all the other classes.

Generally, each series involves an initial reinvestment period, referred to as the "revolving period," in which principal payments on receivables allocated to such series

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are returned to MRI and reinvested in new receivables arising in the accounts. After the revolving period ends, principal payments allocated to the series are then accumulated and used to repay the investors. This period is referred to as the accumulation period, and is followed by a controlled amortization period wherein investors are repaid their invested amount. Currently, the Master Trust has two series in an accumulation period and no series in a controlled amortization period. The scheduled accumulation and amortization periods are set in the agreements governing each series. However, all series set forth certain events by which accumulation and amortization can be accelerated, referred to as "early amortization." Usually, this would occur if the portfolio collections, less charge-offs for bad debt, financing costs and operational costs, drop below zero. New receivables in designated accounts cannot be funded while a series is in early amortization. We currently do not have any series that are in early amortization.

On a monthly basis, each series is allocated its share of finance charge collections, which are used to pay investors interest on their securities, pay their share of servicing fees and reimburse investors for their share of losses due to charge-offs. Amounts remaining may be deposited in cash accounts of the Master Trust as additional protection for future losses. Once each of these obligations is fully met, any remaining finance charge collections, if any, are returned to us.

### Bank-Sponsored Conduit Programs

We maintain flexibility in our current funding program by maintaining primarily bank-sponsored commercial paper conduits. These conduits purchase an interest in receivables arising in designated accounts. These transactions also feature a revolving period in which principal payments on receivables allocated to the conduits are returned to us and reinvested in new receivables. These agreements also have early amortization triggers. Finance charge collections are used to pay certain obligations, including servicing fees, interest on the principal amount of the conduits investment in the applicable receivables, and recouping charge-offs. After such allocation, remaining finance charge collections, if any, are returned to us.

Additional information regarding asset securitization is set forth under the caption "Liquidity, Funding and Capital Resources" on pages 51 through 55 of this Report.



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### Bank-Sponsored Deposit Programs

Direct Merchants Credit Card Bank, N.A. initiated a jumbo certificate of deposit (CD) program in March 1999. The CDs are issued in increments of \$100,000 by FDIC registered investment brokers. The broker is responsible for marketing through its retail sales force, customer service and information distribution, customer record maintenance and tax reporting. The CDs offered have fixed interest rates and original maturities ranging from 6 months to 5 years.

In May 2000, Direct Merchants Credit card Bank, N.A. began offering jumbo CDs directly to investors via advertising in local and national newspapers, in addition to posting rates on several websites. The direct program is run in conjunction with the brokered program with similar terms.

### Recovery Asset Collections and Sales

magnUS Services, Inc. ("magnUS"), our wholly-owned third-party collection agency, services both pre- and post-charged-off debt from a variety of sources. magnUS manages the Direct Merchants Bank charged off portfolio from initial charge-off through account resolution, as well as working pre-determined delinquent billing cycles, prior to an account being charged off. Additionally, magnUS services charged-off debt from other

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third parties and purchased portfolios. magnUS uses sophisticated modeling techniques to target collection efforts toward customers with a high probability of securing payment. Revenue is generated based on collection efforts through contracted contingency rates with third parties. Revenue for purchased portfolios is recognized through accretion accounting.

### Enhancement Services

We market enhancement services in three principal lines of business:

Credit protection and insurance products, including:

- o credit account protection benefits arising from death, unemployment, disability or family leave; and
- o third-party insurance offered directly to our credit card customers.

Membership products, including:

- o membership benefit programs in categories such as credit bureau monitoring, fraud prevention and resolution, travel, credit card purchase protection or automotive assistance.

Warranty products, including:

- o extended service plans for third party retail products; and
- o warranties for home appliances, systems and electronics.

We currently market the following programs:

Credit Protection and Insurance Products

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Credit protection and insurance products are sold exclusively to Direct Merchants Bank credit card customers.

Account Protection Plus<sup>SM</sup> is a program that will waive the balance of a customer's Direct Merchants Bank credit card account (up to the credit limit) in the event of the cardholder's death. It further protects this account in the event of involuntary unemployment, disability or the need to take a Family Medical Leave Act leave of absence from employment. In these situations, the customer's account is "frozen" with no payments due or interest accruing up to the maximum period of time permissible for each event.

Account Benefit Plan is a program that will waive the balance of a customer's Direct Merchants Bank credit card account (up to the credit limit) in the event of the cardholder's death.

Credit Life Insurance offers our credit card customers traditional life insurance benefits that will pay the balance of the Direct Merchants Bank credit card account in the event of the cardholder's death. Additional coverage may be available on a state-by-state basis that will pay the minimum payment due on the covered account in the event of unemployment or disability. The insurance benefits are offered by insurance companies that reinsure those policies with ICOM Limited, our captive insurance subsidiary.

Syndicated Insurance Products. We cooperate with a variety of insurance companies to sell their regulated products to Direct Merchants Bank customers. These transactions may follow different constructs. In the simplest, the insurance company pays us a fee for access to a select list of customers, the opportunity to leverage

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Direct Merchants Bank's name during solicitation and billing processes that we support. When it is in our best interest, we acquire the marketing margin associated with product sales. In this construct, our licensed insurance agency, MES Insurance Agency, LLC, manages all customer solicitation and its expense in exchange for commission. Lastly, in low risk products, our captive insurance company, ICOM Limited, re-insures the risk of the policies sold. This may range from a minority percentage to all risk of loss. In this situation, the administrative costs of servicing these policies are borne by us.

#### Membership Products

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Membership products are sold to customers of Direct Merchants Bank, customers of third-party partners, and directly to consumers.

DirectAlert(R) helps members monitor and review their credit report through the following benefits:

- o unlimited access to their credit report in easy to read paper or electronic (online) formats;
- o regular monitoring updates detailing changes in their credit bureau report;
- o information about inquiries or new trade lines opened in their name; and
- o access to expert information to assist with handling disputes.

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Fraud Alert Services<sup>SM</sup> provides members with a comprehensive ability to deal with the risks associated with the sudden loss of personal financial information. Members receive personal computer firewall software to protect their home computers from attacks by hackers. If credit cards or wallets are lost or stolen, members can have all their issuers notified with a single call and emergency cash or airline tickets can be delivered to travelers away from home. Should any member become the victim of identity theft, experts will help members resolve these issues by assisting with law enforcement officials, credit bureaus and other necessary parties.

PurchaseShield(R) is a membership program that offers various levels of purchase protection to its members. Eligible purchases made on members' credit cards are protected with the following benefits:

- o extended manufacturers warranty;
- o sale price protection; and
- o product return guarantee.

In addition, PurchaseShield(R) offers its members a household repair rebate that can be used on certain in-home electro-mechanical item repairs. This program is administered internally, and all revenues and expenses are our responsibility.

RoadSaver<sup>SM</sup> provides members with emergency roadside assistance, an automotive mechanic helpline, customized trip planning, and car buyer information services. Members are covered regardless of the car in which they are traveling, and a single RoadSaver<sup>SM</sup> membership covers all household family members.

TripSaver<sup>SM</sup> gives members a broad array of travel benefits - access to a full service travel agency, driving vacation packages, restaurant and entertainment discounts, automotive maintenance rebates and other special travel offers.

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### Warranty Products

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Extended Service Plans. We issue and administer extended service plans that provide warranty coverage beyond the manufacturer's warranty period. In general, the extended service plans that we issue and administer provide customers with the right to have their covered purchases repaired, replaced, or in certain circumstances, the purchase price of the product refunded, within certain limits that we determine. The extended service plans that we have historically sold were to customers of Fingerhut, and with the likely conclusion of catalog sales operations at Fingerhut, we anticipate these programs to be in run-off. We will issue and administer the following programs over a period of up to three years based upon the original term purchased by a consumer. We are responsible for all claims made during this period.

ServiceEdge(R) is an extended service plan issued and administered by us for consumer electronics and other electro-mechanical items. ServiceEdge(R) customers have the right to have their purchases repaired or replaced in the event of electrical or mechanical failure or defects in materials and workmanship for covered events after the manufacturer's warranty expires.

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Quality Furniture CareSM is our extended service plan program for furniture. The services provided to Quality Furniture CareSM customers include stain cleaning, structural defect or damage repair, or replacement if the merchandise cannot be repaired.

Quality Jewelry CareSM is our extended service plan for jewelry. The services provided to Quality Jewelry CareSM customers include repair, soldering, ring sizing, prong re-tipping and cleaning.

Home Warranties offer consumers a bundled coverage of existing home appliances, electronics, heating, ventilation, or air conditioning systems, plumbing and electrical service. These are relatively common products that protect the consumer beyond the usual manufacturer's warranty. We issue and administer products that offer a variety of coverages. We are responsible for all revenues and claims costs of these products. These products are marketed to the customers of Direct Merchants Bank and our third party partners, as well as to the broad market.

Home ServiceEdgeSM covers repairs for up to 11 major home appliances and systems. It is targeted toward homeowners or consumers who have responsibility for the upkeep of their kitchen and utility appliances, and home heating/cooling systems. The plan will assist the customer in locating and arranging for repair service for covered products. In the event that a covered product cannot be fixed, we will pay a set dollar amount toward the replacement of the product. Home ServiceEdgeSM offers several different coverage and price point options to customers based upon their individual need.

Home Electronics Warranty covers common consumer home electronics, principally audio-visual products. We have designed this product to appeal to a broad spectrum of consumers, whether they are homeowners or renters.

### Competition

As a marketer of consumer lending products, we compete with numerous providers of financial services, many of which have greater resources than we do. In particular, our credit card business competes with national, regional and local bankcard issuers as well as other general purpose credit and debit card issuers. In general, customers are attracted to credit card issuers largely on the basis of price, credit limit and other product features; as a result, customer loyalty is often limited. However, we believe

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that our strategy of focusing on the moderate-income sector and our proprietary prospect database, proprietary models and internal credit scores allow us to compete effectively in the market for moderate-income cardholders. There are numerous competitors in the enhancement services market, including insurance companies, financial services institutions and other membership-based or consumer-enhancement service providers.

### Regulation

#### The Company and Direct Merchants Bank

Direct Merchants Bank is a limited purpose credit card bank chartered as a national banking association. It is a member of the Federal Reserve System. Its deposits are insured by the Bank Insurance Fund which is administered by the Federal Deposit Insurance Corporation ("FDIC") and it is subject to comprehensive regulation and periodic examination by the Office of the

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Comptroller of the Currency ("OCC"), its primary regulator. It is also subject to regulation by the FDIC, as a back-up regulator. Direct Merchants Bank is not a "bank" as defined under the Bank Holding Company Act of 1956 ("BHCA"), as amended, because it:

- o engages only in credit card operations;
- o does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others;
- o does not accept any savings or time deposits of less than \$100,000, except for deposits pledged as collateral for extensions of credit;
- o maintains only one office that accepts deposits; and
- o does not engage in the business of making commercial loans.

If Direct Merchants Bank failed to meet the credit card bank criteria described above, Direct Merchants Bank's status as an insured bank would make us subject to the provisions of the BHCA. We believe that becoming a bank holding company would limit our ability to pursue future opportunities.

The OCC, as our primary regulator, has established operating guidelines for national banks. As part of their normal periodic examination process, the OCC may, in its sole discretion, require banks to modify or stop current practices based on their interpretation of those guidelines. Such changes to our current or planned practices may have an impact on the capital, liquidity, earnings and management of Direct Merchants Bank, which in turn may impact MCI.

The OCC, the Federal Reserve Board, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision are expanding previously issued examination guidance for supervising subprime lending activities. This expanded guidance includes expectations for the allowance for loan losses and regulatory capital. Under the expanded guidance, the allowance for loan losses required for subprime loans should be sufficient to absorb at least all estimated credit losses on outstanding balances over the current operating cycle, typically 12 months. Each subprime lender is responsible for quantifying the amount of capital needed to offset the additional risk in subprime lending activities, and for fully documenting the methodology and analysis supporting the amounts specified. Given the higher risk inherent in subprime lending programs, examiners may expect that Direct Merchants Bank would hold capital against subprime

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portfolios in an amount that is one and one half to three times greater than what is appropriate for non-subprime assets of a similar type.

### Exportation of Interest Rates and Fees

Under current judicial interpretations of federal law, national banks such as Direct Merchants Bank may charge interest at the rate allowed by the laws of the state where the bank is located and may "export" those interest rates on loans to borrowers in other states, without regard to the laws of such other states.

The United States Supreme Court has held that national banks may also impose late payment fees, overlimit fees, annual fees, cash advance fees and membership fees allowed by the laws of the state where the national bank is located on borrowers in other states, without regard to the laws of such other

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states. The Supreme Court based its opinion largely on its deference to a regulation adopted by the OCC that has been interpreted to permit national banks to export interest rates. As a result, national banks such as Direct Merchants Bank may export such fees.

### Dividends and Transfers of Funds

There are various federal law limitations on the extent to which Direct Merchants Bank can finance or otherwise supply funds to MCI and its affiliates through dividends, loans or otherwise. These limitations include:

- o minimum regulatory capital requirements;
- o restrictions concerning the payment of dividends out of net profits or surplus; and
- o Sections 23A and 23B of the Federal Reserve Act governing transactions between a bank and its affiliates.

In general, federal law prohibits a national bank such as Direct Merchants Bank from making dividend distributions on common stock if the dividend would exceed currently available undistributed profits. In addition, Direct Merchants Bank must get OCC approval prior to paying a dividend, if such distribution would exceed current year net income combined with retained earnings from the prior two years. Direct Merchants Bank cannot make a dividend if the distribution would cause it to fail to meet applicable capital adequacy standards. Finally, although not a regulatory restriction, the terms of certain debt agreements prohibit the payment of dividends in certain circumstances.

### Capital Adequacy

The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") requires the banking agencies to prescribe certain non-capital standards for safety and soundness relating generally to operations and management, asset quality and executive compensation. FDICIA also provides that regulatory action may be taken against a bank that does not meet such standards.

The OCC has adopted regulations that define the five capital categories (well-capitalized, adequately-capitalized, undercapitalized, significantly-undercapitalized and critically-undercapitalized) identified by FDICIA, using the total risk-based capital, Tier 1 risk-based capital and leveraged capital ratios as the relevant capital measures. Such regulations establish various degrees of corrective action to be taken when an institution is considered undercapitalized. Under the regulations, a "well-capitalized" institution must have a Tier 1 capital ratio of at least 6%, a total capital ratio of at least 10% and a leverage ratio of at least 5% and not be subject to

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a capital directive order. Under these guidelines, Direct Merchants Bank is considered well-capitalized.

The OCC's risk-based capital standards explicitly consider a bank's exposure to declines in the economic value of its capital due to changes in interest rates when evaluating a bank's capital adequacy. Interest rate risk is the exposure of a bank's current and future earnings and equity capital arising from adverse movements in interest rates. The evaluation will be made as a part of the institution's regular safety and soundness examination.

The FDICIA requires the FDIC to implement a system of risk-based premiums

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for deposit insurance pursuant to which the premiums paid by a depository institution will be based on the probability that the FDIC will incur a loss in respect of such institution. The FDIC has adopted a system that imposes insurance premiums based upon a matrix that takes into account a bank's capital level and supervisory rating.

Under FDICIA, only "well-capitalized" and "adequately-capitalized" banks may accept brokered deposits. Direct Merchants Bank may accept deposits as part of its funding and began issuing certificates of deposit ("CDs") in the first quarter of 1999. These CDs are issued through third-party registered deposit brokers and directly to the public in increments of \$100,000 or more.

### Lending Activities

Direct Merchants Bank's activities as a credit card lender are also subject to regulation under various federal consumer protection laws including the Truth-in-Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Community Reinvestment Act ("CRA") and the Soldiers' and Sailors' Civil Relief Act. Regulators are authorized to impose penalties for violations of these statutes and, in certain cases, to order Direct Merchants Bank to pay restitution to injured cardholders. Cardholders may also bring actions for certain alleged violations of such regulations. Federal and state bankruptcy and debtor relief laws also affect Direct Merchants Bank's ability to collect outstanding balances owed by cardholders who seek relief under these statutes.

The OCC's CRA regulations subject limited purpose banks, including Direct Merchants Bank, to a "community development" test for evaluating required CRA compliance. The community development performance of a limited purpose bank is evaluated pursuant to various criteria involving community development lending, qualified investments and community development services.

### Legislation

Congress has passed a financial services law that will require many of our business groups to disclose our practices for collection and sharing of non-public customer information. The regulations associated with this law could require us to limit or substantially modify our enhancement services and credit card marketing activities and practices with third-party companies in ways that could adversely affect us if these changes result in limits on sharing information. Furthermore, there is similar or related legislation currently pending or under consideration at the federal and state level.

From time to time legislation has been proposed in Congress to limit interest rates and fees that could be charged on credit card accounts or otherwise restrict practices of credit card issuers. If this or similar legislation is adopted, our ability to collect on account balances or maintain previous levels of finance charges and other fees could be adversely affected.

Additionally, the U.S. Senate and House of Representatives have each passed legislation that would amend the federal bankruptcy laws. This legislation, a form of which is expected to be signed into law, is generally considered to be favorable to the credit card industry. However, any changes to state debtor relief and collection laws could adversely affect us if such changes result in, among other things, accounts being charged off as uncollectible and additional administrative expenses. Congress and the states may in the future consider other legislation that would materially affect the credit card and related enhancement services industries.

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### Consumer and Debtor Protection Laws

Various federal and state consumer protection laws limit our ability to offer and extend credit. In addition, the U.S. Congress and the states may decide to regulate further the credit card industry by enacting laws or amendments to existing laws to reduce finance charges or other fees or charges applicable to credit card and other consumer revolving loan accounts. These laws may adversely affect our ability to collect on account balances or maintain established levels of periodic rate finance charges and other fees and charges with respect to the accounts. Similarly, Congress, the OCC and/or the states may decide to further regulate our enhancement services.

### Investment in the Company and Direct Merchants Bank

Certain acquisitions of capital stock may be subject to regulatory approval or notice under federal law. Investors are responsible for insuring that they do not directly or indirectly acquire shares of our capital stock in excess of the amount that can be acquired without regulatory approval.

### Interstate Taxation

Several states have passed legislation attempting to tax the income from interstate financial activities, including credit cards, derived from accounts held by their residents. We believe this legislation will not materially affect us. Our belief is based upon current interpretations of the enforceability of this legislation, prior court decisions and the volume of business in states that have passed this legislation.

### Licensing Requirements

Several state and local government regulators require our subsidiaries to be licensed in order to offer our enhancement services insurance and warranty products in these states. We are in the process of obtaining licenses for these products in the remainder of states. Our captive insurance subsidiary, ICOM Limited, is licensed in Bermuda under The Insurance Act of 1978 as a Class 2 Insurer. We are restricted from writing any long-term policies or pursuing any unrelated business in excess of certain limits under Bermuda law.

### Fair Credit Reporting Act

The Fair Credit Reporting Act ("FCRA") regulates consumer reporting agencies. Under the FCRA, an entity risks becoming a consumer reporting agency if it furnishes consumer reports to third parties. A consumer report is a communication of information which bears on a consumer's creditworthiness, credit capacity, credit standing or certain other characteristics and which is collected or used or expected to be used to determine the consumer's eligibility for credit, insurance, employment or certain other purposes. The FCRA explicitly excludes from the definition of consumer report a report containing information solely as to transactions or experiences between the consumer and the entity making the report. An entity may share consumer reports with any of its affiliates so long as that entity provides consumers with an appropriate disclosure and an opportunity to opt out of such affiliate sharing.

Our objective is to conduct our operations in a manner that would fall outside the definition of consumer reporting agency under the FCRA. If we were to become a consumer reporting agency, however, we would be subject to a number of complex and burdensome regulatory requirements and restrictions. Such



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restrictions could have a significant adverse economic impact on us.

### Employees

As of December 31, 2001, we had over 4,000 employees located in Arizona, Florida, Illinois, Maryland, Minnesota and Oklahoma. None of our employees are represented by a collective bargaining agreement. We consider our relations with our employees to be good.

### Trademarks, Trade Names and Service Marks

MCI and its subsidiaries have registered and continue to register, when appropriate, various trademarks, tradenames and service marks used in connection with its business and for private label marketing of certain of its products. We consider these trademarks and service marks to be readily identifiable with, and valuable to, our business.

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### Executive Officers of the Registrant

The following table sets forth certain information concerning the persons who currently serve as our executive officers. Each executive officer serves at the discretion of our Board of Directors.

Name	Age	Position
Ronald N. Zebeck	47	Chairman and Chief Executive Officer
David D. Wesselink	59	Vice Chairman
William R. Anderson	44	Executive Vice President, Enhancement Services
Richard G. Evans	53	Executive Vice President, General Counsel and Secretary
Patrick J. Fox	46	Executive Vice President, Business Development; President, Direct Merchants Bank
Joseph A. Hoffman	44	Executive Vice President, Consumer Credit Card Marketing/Operations
Matthew S. Melius	36	Executive Vice President, Credit Risk Management
Jon B. Mendel	50	Executive Vice President, Human Resources
David R. Reak	43	Executive Vice President, Risk Management/Recovery
Benson K. Woo	47	Chief Financial Officer
Dan N. Piteleski	51	Senior Vice President, Chief Information Officer

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John A. Witham	50	Senior Vice President, Finance
Ralph A. Than	41	Senior Vice President, Treasurer
Mark P. Wagener	41	Senior Vice President, Controller

Ronald N. Zebeck has been our Chairman and Chief Executive Officer since May 2000 and previously served as President and Chief Executive Officer since our incorporation in August 1996. Mr. Zebeck has been President of Metris Direct, Inc. since March 1994 and has served as Chairman of the Board of Direct Merchants Bank since August 1995. Prior to joining us, Mr. Zebeck was Managing Director, GM Card Operations of General Motors Corporation from 1991 to 1993, Vice President, Marketing and Strategic Planning of Advanta Corporation (Colonial National Bank USA) from 1987 to 1991, Director of Strategic Planning of TSO Financial (later Advanta Corporation) from 1986 to 1987, and held various credit card and credit-related positions at Citibank affiliates from 1976 to 1986. Mr. Zebeck is also a director of MasterCard International, Inc.

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David D. Wesselink has been Vice Chairman of the Company since September 2000. Mr. Wesselink previously held the position of Executive Vice President, Chief Financial Officer from December 1998. Prior to joining us, Mr. Wesselink was Senior Vice President and Chief Financial Officer of Advanta Corporation from 1993 to 1998. Prior to Advanta Corporation, he held several positions at Household Finance Corp. and Household International, Inc. from 1971 to 1993, including Senior Vice President from 1986 to 1993 and Chief Financial Officer from 1982 to 1993.

William R. Anderson has been Executive Vice President, Enhancement Services since February 2002. Mr. Anderson previously served as Senior Vice President, Enhancement Services from October 1999 to February 2002, and Senior Vice President, E-Commerce from February 1999 to October 1999. Prior to joining us, Mr. Anderson was Executive Vice President and Director of Marketing at Bank of America from 1996 to 1999. Prior to Bank of America, Mr. Anderson was General Director of U.S. Consumer Marketing at the GM Card operations at General Motors Corporation.

Richard G. Evans has been Executive Vice President, General Counsel and Secretary since June 2001. Prior to joining us, Mr. Evans was Executive Vice President, General Counsel and Director of Green Tree Financial Corporation from 1985 to 1999. Prior to Green Tree, Mr. Evans served as Special Assistant Attorney General for the State of Minnesota from 1974 to 1984.

Patrick J. Fox has been Executive Vice President, Business Development since September 2000. Mr. Fox previously served as Senior Vice President, Business Development from March 1998. Prior to joining us, Mr. Fox held executive positions in the credit card group of Bank of America from 1994 to March 1998, including Director of Product Management and Business Development. Prior to Bank of America, Mr. Fox held various marketing and sales management positions with Bank One, which he joined in 1992, Comerica Bank and Citibank. Mr. Fox has been President of Direct Merchants Bank since March 2000.

Joseph A. Hoffman has been Executive Vice President, Consumer Credit Card Marketing/Operations since October 1999. Mr. Hoffman previously served as Senior Vice President, Consumer Credit Marketing from April 1998. Prior to joining us, Mr. Hoffman was Vice President of Marketing at Advanta Corporation from June 1994 to April 1998, where he held a variety of positions including Director of

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Brand Management and Affinity and Co-Brand Marketing. Before that, Mr. Hoffman was Vice President, Area Director, in Citibank's Card Product Group, which he joined in 1980. During his fourteen-year tenure with Citibank, Mr. Hoffman held a variety of marketing and operations positions with Citibank's Bankcard and Private Label businesses.

Matthew S. Melius has been Executive Vice President, Credit Risk Management since January 2001. Mr. Melius previously served as Executive Vice President, E-Commerce from September 2000, Senior Vice President, E-Commerce from January 2000, Senior Vice President, Portfolio Marketing from January 1998, Vice President, Portfolio Marketing from January 1997, and Director, Portfolio Marketing from September 1995. Prior to joining us, Mr. Melius was Director, Customer Retention of First National Bank of Omaha in the Credit Card Division from 1989 to 1995.

Jon B. Mendel has been Executive Vice President, Human Resources since May 1998. Prior to joining us, Mr. Mendel was Senior Vice President, Human Resources at TCF Financial Corporation. Prior to TCF, Mr. Mendel held various positions at the St. Paul Companies, including Vice President, Human Resources of the St. Paul Fire and Marine Insurance Company.

David R. Reak has been Executive Vice President, Risk Management/Recovery since October 1999. Mr. Reak previously served as Senior Vice President, Credit Risk from November 1998. Mr. Reak was appointed Vice President, Credit Risk in October 1996 and

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previously served as Senior Director, Credit Risk of Metris Direct, Inc. from December 1995 to October 1996. Prior to joining us, he held several positions at American Express Travel Related Services Company, including Senior Manager, Credit Risk Management Europe and Middle East from 1994 to December 1995, Senior Manager, Credit Risk Management U.S. Consulting Group from 1992 to 1994, and Project Manager, Credit Research and Analysis from 1990 to 1992.

Benson K. Woo has been Chief Financial Officer since September 2000. Mr. Woo previously held the position of Senior Vice President, Finance from October 1999. Prior to joining us, Mr. Woo was Vice President and Chief Financial Officer of York International Corporation from 1998 to 1999. Prior to York International Corporation, he was Vice President and Treasurer of Case Corporation from 1994 to 1998. Prior to that, he held several positions at General Motors Corporation from 1979 to 1994, including Finance Director, GM Credit Card Operations from 1992 to 1994.

Dan N. Piteleski has been Senior Vice President, Chief Information Officer since April 2001. Prior to joining us, Mr. Piteleski was Vice President, Chief Information Officer of H.B. Fuller Company from 1995. Prior to H.B. Fuller, he was Vice President, Information Systems at Zenith Data Systems from 1992, and Manager, Information Systems and Technology at Apple Computer from 1988.

John A. Witham has been Senior Vice President, Finance since June 2002. Mr. Witham previously held the position of Executive Vice President, Chief Financial Officer of Bracknell Corporation from November 2000. Prior to Bracknell, he served as Executive Vice President, Chief Financial Officer of Arcadia Financial Ltd. from 1994 to 2000. Prior to Arcadia, Mr. Witham served as Senior Vice President, Finance of various operating units of PHH Corporation from 1985 to 1994.

Ralph A. Than has been Senior Vice President, Treasurer since May 2000. Prior to joining us, Mr. Than was Vice President, Treasurer of CNH Capital Corporation, the finance subsidiary of CNH Global N.V. from 1998 to 2000. Before

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that, he was Group Controller of the Agricultural Systems Business Unit of Case Corporation from 1997 to 1998.

Mark P. Wagener has been Senior Vice President, Controller since October 2001. Mr. Wagener previously served as Vice President, Assistant Controller from June 2000. Prior to joining us, he held several positions at Norwest Corporation (Wells Fargo & Company) from 1988 to 1999. Prior to Norwest, Mr. Wagener was an audit manager at Arthur Andersen LLP from 1982 to 1987.

Our officers are elected by, and hold office at the will of, our Board of Directors and do not serve a "term of office" as such.

### Risk Factors

This Annual Report on Form 10-K/A contains certain forward-looking statements and information relating to MCI that are based on the beliefs of our management as well as assumptions made by, and information currently available to, our management. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from such statements. You should not place undue reliance on these forward-looking statements as they speak only of our views as of the date the statement was made and are not a guarantee of future performance.

Forward-looking statements include statements and information as to our strategies and objectives, growth in earnings per share, return on equity, growth in our managed loan portfolio, net interest margins, funding costs, operating costs and marketing expenses, delinquencies and charge-offs and industry comparisons or projections.

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Forward-looking statements may be identified by the use of terminology such as "may," "will," "believes," "does not believe," "no reason to believe," "expects," "plans," "intends," "estimates," "anticipated," or "anticipates" and similar expressions, as they relate to the Company or our management. These statements reflect management's current views with respect to future events and are subject to certain risks, uncertainties and assumptions.

The factors discussed below, among others, could cause our actual results to differ materially from those expressed in any forward-looking statements. Although we have attempted to list comprehensively these important factors, we caution you that other factors may in the future prove to be important in affecting our results of operations. New factors emerge from time to time and it is not possible for us to predict all of these factors, nor can we assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

### Our Target Market for Consumer Lending Products Has Higher Default and Bankruptcy Rates

The primary risk associated with secured and unsecured lending to moderate-income consumers is higher default rates than other income classes of consumers, resulting in more accounts being charged off as uncollectible. In addition, general economic factors, such as the rate of inflation, unemployment levels and interest rates, may result in greater delinquencies and credit losses among moderate-income consumers than among other income classes of consumers. A recession or economic downturn may cause an increase in default rates and

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delinquencies. We may be unable to successfully identify and evaluate the creditworthiness of our target customers to minimize the expected higher delinquencies and losses. We also cannot assure you that our risk-based pricing system can offset the negative impact on profitability that the expected greater delinquencies and losses may have.

### We May Not be Able to Sustain and Manage Growth

In order to meet our strategic objectives, we plan to continue to expand our credit card loan portfolio. Continued growth in this area depends largely on:

- o our ability to attract new cardholders;
- o growth in both existing and new account balances;
- o the degree to which we lose accounts and account balances to competing card issuers;
- o levels of delinquencies and losses;
- o the availability of funding, including securitizations, on favorable terms;
- o general economic and other factors such as the rate of inflation, unemployment levels and interest rates, which are beyond our control;
- o our ability to acquire and integrate portfolios; and
- o stability and growth in management.

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Our continued growth also depends on our ability to manage this growth effectively. Factors that affect our ability to successfully manage growth include:

- o retaining and recruiting experienced management personnel;
- o finding and adequately training new employees; o cost-effectively expanding our facilities;
- o growing and updating our management systems; and
- o obtaining capital when needed.

### We May Not be Able to Successfully Market Our Enhancement Services or Sign Additional Marketing Alliances

We target our enhancement services to our credit card customers and customers of third parties. Because of the variety of offers provided and the diversity of the customers targeted, we are uncertain about how many customers will respond to our offers for these enhancement services. We may experience higher than anticipated costs in connection with the internal administration and underwriting of these enhancement services and lower than anticipated response or retention rates.

Furthermore, we may be unable to expand the enhancement services business or maintain historical growth and stability levels if:

- o we cannot successfully market credit cards to new customers;

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- o existing credit card customers close accounts voluntarily or involuntarily;
- o existing enhancement services customers cancel their services;
- o we cannot form marketing alliances with other third parties or existing marketing alliances with third parties terminate; or
- o new or restrictive federal or state regulations limit our ability to market or sell enhancement services.

### Our Profitability and Ability to Grow is Dependent on Our Funding Sources Securitization Markets

As of December 31, 2001, 70% of our receivables were funded through the securitization market. These markets could undergo disruptions which adversely affected the ability of companies like us to raise money from these sources. Factors impacting these markets include current economic conditions, the financial condition of other institutions accessing these markets and national/world events. Furthermore, our ability to securitize our receivables depends on the legal, regulatory and tax environment for such transactions.

In addition, even if we are able to securitize our receivables consistent with past practice, poor performance of our securitized receivables, including increased delinquencies and credit losses, lower payment rates or a decrease in excess spreads below certain thresholds could result in a downgrade or withdrawal of the ratings on the outstanding securities issued in our securitization transactions, cause early amortization of such securities or result in higher required credit enhancement levels. As a result, poor performance of our securitized receivables could divert significant

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amounts of cash that would otherwise be available to us. This could jeopardize our ability to complete other securitization transactions on acceptable terms, decrease our liquidity and force us to rely on other potentially more expensive funding sources, to the extent available. We cannot assure you that the securitization market will continue to offer suitable funding alternatives.

### Credit Facility

We rely on our credit facility to fund our operations and growth. If we breach any of our covenants under our credit facility, including various financial covenants, the lenders may terminate the facility. Disruptions in the securitization market could negatively affect our ability to comply with these covenants, and therefore our ability to borrow or replace this facility could be adversely affected.

### CD Program

Direct Merchants Bank issues certificates of deposit in increments of \$100,000 or more. We expect to use the proceeds of these deposits to fund our operations and growth. In order to maintain our current level of access to the certificate of deposit market, Direct Merchants Bank must maintain a "well-capitalized" rating, as that rating is defined by the OCC. If it does not do so, Direct Merchants Bank may be required to modify the program and may not be able to accept additional deposits.

### Other Funding Sources

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We also expect to obtain financing by selling debt and equity securities. Our ability to obtain such financing is dependent upon many factors, including general market conditions. We cannot assure you that we will be able to obtain this financing on favorable terms or at all. In addition, restrictions contained in our debt agreements may adversely affect our ability to finance future operations or capital needs or to engage in other business activities.

Our ability to obtain financing from the various sources available to us is dependent upon many factors, including those outside of our control. In addition, disruptions or unfavorable conditions related to one financing source may negatively affect our ability to access other financing sources, or may increase our financing costs.

### We Require a High Degree of Liquidity to Operate Our Business

We depend on cash flows from operations, asset securitizations, bank loans, subsidiary bank deposit programs, long-term debt and equity issuances to fund our operations and growth. The loss or interruption of any of these sources of funding could adversely affect our ability to operate.

Key elements of our strategy are dependent upon us having adequate available cash. These cash needs include:

- o funding receivable growth through marketing campaigns;
  - o additional credit enhancement in the case of poor performance of our securitized assets;
  - o interest and principal payments under our securitizations, our credit agreement, our existing senior notes and other indebtedness;
  - o ongoing operating expenses;
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- o maintenance of the "well-capitalized" status of our subsidiary, Direct Merchants Bank, which is necessary to maintain the CD program;
  - o portfolio and business acquisitions;
  - o fees and expenses incurred in connection with the securitization of receivables and the servicing of them; and
  - o tax payments due on receipt of excess cash flow from securitization trusts.

Given these cash needs, we anticipate that we will need to enter into financing transactions on a regular basis. We cannot assure you that we will be able to secure funds to support our cash needs on terms as favorable as past transactions. Any adverse change in the funding sources we use could force us to rely on other potentially more expensive funding sources, to the extent available, and could have other adverse consequences. If any of our funding sources become limited it may require us to use more expensive sources of funding. Any material increase in our costs of financing beyond our expectations could negatively impact us.

### Interest Rate Fluctuations Impact the Yield on Our Assets and Funding Expense

An increase or decrease in market interest rates could have a negative

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impact on the net interest spread between the yield on our assets and our cost of funding. A rise in market interest rates may indirectly impact the payment performance of our customers. We try to minimize the impact of changes in market interest rates on our cash flow, asset value and net income primarily by funding variable-rate assets with variable-rate funding sources and by using interest rate derivatives to match asset and liability repricings. However, changes in market interest rates may have a negative impact on us.

### We May Not be Able to Successfully Integrate Portfolio Acquisitions

As previously mentioned, our growth may depend on our ability to acquire and successfully integrate new portfolios of credit card customers. Since our risk-based pricing system depends on information regarding customers, limited or unreliable historical information on customers within an acquired portfolio may have an impact on our ability to successfully and profitably integrate that portfolio. Our success also depends on whether the desirable customers of an acquired portfolio close their accounts after transfer of the portfolio. A large attrition rate would result in a lower borrowing base upon which to assess fees, higher costs relating to closing accounts and less potential for marketing enhancement services. In addition, if customers reduce their borrowings after the transfer of accounts, the acquired portfolio may be less profitable than originally expected.

### Current and Proposed Regulation and Legislation Limit Our Business Activities, Product Offerings and Fees Charged

Various federal and state laws and regulations significantly limit the activities in which we and Direct Merchants Bank are permitted to engage. Such laws and regulations, among other things, limit the fees and other charges that we are allowed to charge, limit or prescribe certain other terms of our products and services, require specified disclosures to consumers, govern the sale and terms of products and services we offer and require that we maintain certain licenses, qualifications, or capital requirements (see "Business - Regulation" on pages 19 through 23 of this Report). In some cases, the precise application of these statutes and regulations is not clear. In addition,

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the regulatory framework at the state and federal level regarding some of our enhancement services is evolving. The regulatory framework affects the design or profitability of such products and our ability to sell certain products. In addition, numerous legislative and regulatory proposals are advanced each year which, if adopted, could adversely affect our profitability or further restrict the manner in which we conduct our activities. The failure to comply with, or adverse changes in, the laws or regulations to which our business is subject, or adverse changes in the interpretation thereof, could adversely affect our ability to collect our receivables and generate fees on the receivables which could have a material adverse effect on our business.

### The Impact of Existing, Pending and Possible Future Privacy Laws Could Result in Lower Marketing Revenue and Penalties for Non-Compliance

Effective July 2001, the federal Gramm-Leach-Bliley Act requires many of our business groups to disclose our practices for collection and sharing of non-public customer information. Changes to this law, or enactment of new laws, have required and could further require us to limit or substantially modify our enhancement services and credit card marketing activities and practices with third-party companies in ways that would most likely decrease our revenue from that business. These initiatives could require us to end substantially all of our marketing efforts with third parties and may even adversely affect the



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ability of the subsidiary through which we issue our credit card products, Direct Merchants Bank, to share information about its customers with other MCI affiliates, particularly enhancement services. The curtailment of our marketing efforts directed to our customer base and third-party customers would significantly negatively impact our business.

The privacy laws require us to provide initial and continuing disclosures regarding our information sharing practices. The laws also require us to monitor these disclosures and customer responses so that we do not unlawfully disclose information about a customer who has directed us not to do so. If we do not adequately manage the requirements, we may face regulatory sanctions, including fines, and consumer class action litigation.

### Other Industry Risks Related to Consumer Lending Products and Enhancement Services Could Negatively Impact Us

We face a number of risks associated with unsecured lending. These include the risk that delinquencies and credit losses will increase because of future economic downturns; the risk that an increasing number of customers will default on the payment of their outstanding balances or seek protection under bankruptcy laws; and the risk that fraud by cardholders and third parties will increase. We also face the risk that increased criticism from consumer advocates and the media could hurt consumer acceptance of our products, as well as the risk of litigation, including class action litigation, challenging our product terms, rates, disclosures, collections or other practices, under state and federal consumer protection statutes and other laws.

### Due to Intense Competition in Our Consumer Lending Products and Enhancement Services Businesses, We May Not be Able to Compete Successfully

We face intense and increasing competition from numerous financial services providers, many of which have greater resources than us. In particular, our credit card business competes with national, regional and local bankcard issuers, as well as other general purpose and private label credit card issuers. There has been a recent increase in solicitations to moderate-income consumers, as competitors have increasingly focused on this market. Customers are attracted to credit card issuers largely on the basis of price, credit limit and other product features; as a result, customer loyalty is often limited. According to published reports, as of December 2001, the 20 largest issuers accounted for approximately 90% (based on receivables outstanding) of the market for general purpose credit cards. Many of these issuers are substantially larger, have more seasoned credit card portfolios and often compete for customers by offering lower

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interest rates and/or fee levels than us. We cannot assure you that we will be able to compete successfully in this environment.

We also face competition from numerous enhancement services providers, including insurance companies, financial services institutions and other membership-based or consumer services providers. As we continue to expand our extended service plan business to the customers of third-party retailers, we compete with manufacturers, financial institutions, insurance companies and a number of independent administrators.

## Item 2. Properties

We currently lease our principal executive office space in Minnetonka,

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Minnesota, consisting of leases for approximately 300,000 and 19,000 square feet. These leases expire in December 2011 and March 2005, respectively. We also lease 15,000 square feet of warehouse space in Minnetonka, Minnesota, which expires in October 2003. Direct Merchants Bank leases office space in Scottsdale, Arizona, consisting of approximately 26,000 square feet. This lease will terminate by advance notice in June 2002. In addition, Direct Merchants Bank purchased a 130,000 square foot building in Scottsdale, Arizona in 1999. This building serves as western regional headquarters for us and Direct Merchants Bank's operation center. In addition, we lease facilities in Tulsa, Oklahoma, White Marsh, Maryland, Jacksonville, Florida, Champaign, Illinois, and Duluth, Minnesota, consisting of approximately 100,000, 115,000, 160,000, 15,000 and 20,000 square feet, respectively. These leases expire in December 2010, September 2007, June 2005, March 2002 and September 2006, respectively. The leased properties in Oklahoma, Maryland, Florida and Duluth, Minnesota support our collections, customer service and back office operations. We also own our Hispanic operations center in Orlando, Florida, which consists of approximately 25,000 square feet. We believe our facilities are suitable to our businesses and that we will be able to lease or purchase additional facilities as needed.

### Item 3. 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 account holders 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 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 it 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.

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 account holders 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.

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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.

### Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders during the fourth quarter of our fiscal year ended December 31, 2001.

## PART II

### Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

The information required by Item 201 of Regulation S-K is set forth in the "Summary of Consolidated Quarterly Financial Information and Stock Data" on pages 106 and 107 of this Report.

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### Item 6. Table 1: Selected Financial Data

	Year Ended December 31,				
	2001	2000	1999	1998	1997
	----	----	----	----	----
(In thousands, except EPS, dividends and stock prices)					
Income Statement Data:					
Net interest income .....	\$ 530,710	\$ 371,772	\$ 180,328	\$ 82,698	\$ 57,770
Provision for loan losses .....	549,145	388,234	174,800	77,770	43,770
Other operating income .....	1,154,457	933,787	623,772	315,480	187,770
Other operating expense .....	714,154	594,414	437,984	227,160	139,770
-----					
Income before income taxes, extra-ordinary loss and cumulative effect of accounting changes .....	421,868	322,911	191,316	93,248	61,770
Tax rate .....	38.3%	38.5%	39.7%	38.5%	38.5%
Net income (1) .....	\$ 260,291	\$ 198,591	\$ 115,363	\$ 57,348	\$ 38,770
-----					
Per Common Share Statistics:					
EPS - diluted (1) .....	\$ 2.62	\$ 2.15	\$ 1.41	\$ 0.94	\$ 0.62
Stock price (year-end split adjusted).....	25.71	26.31	23.79	16.77	11.77
Dividends paid (split adjusted) .....	0.040	0.033	0.017	0.013	0.013
Book value per common share equivalent (split adjusted) (2)...	12.00	9.68	7.38	5.85	4.85
Shares outstanding (year-end) .....	63,419	62,243	57,919	57,779	57,779
Shares used to compute EPS (diluted) .....	99,366	92,582	76,324	59,905	60,324
-----					
Selected Operating Data:					
Total accounts .....	4,929	4,464	3,680	2,972	2,972
Year-end credit card loans .....	\$2,746,656	\$1,179,203	\$ 145,783	\$ --	\$ --
Year-end assets .....	4,228,686	3,736,025	2,045,082	945,719	538,686

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Average credit card loans .....	1,709,989	614,991	20,505	--	
Average interest-earning assets ....	3,955,328	2,707,769	1,303,528	636,133	403
Average assets .....	3,903,846	2,826,653	1,449,297	774,167	417
Average total equity .....	1,011,573	759,633	542,050	219,835	158
Year-end deposits .....	2,058,008	2,106,199	775,381	--	
Year-end debt .....	647,904	356,066	345,012	310,896	244
Year-end preferred stock .....	393,970	360,421	329,729	201,100	
Return on average assets (1) .....	6.7%	7.0%	8.0%	7.4%	
Return on average total equity (1) .	25.7%	26.1%	21.3%	26.1%	

Selected Enhancement Services Data:

Revenue:

Credit protection .....	\$ 202,300	\$ 149,421	\$ 109,502	\$ 73,773	\$ 47
Membership products .....	94,695	75,981	31,858	13,301	4
Warranty/other .....	43,137	40,798	33,731	22,049	12
-----					
Total revenue .....	340,132	266,200	175,091	109,123	64
-----					
Year-end deferred revenue .....	185,132	199,796	127,541	72,866	35

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Year-end deferred acquisition costs.	79,400	74,084	45,837	23,726	15
Total enrollments .....	3,475	4,809	3,294	2,441	2
Third-party enrollments .....	1,398	1,675	1,336	1,316	1
Active members .....	5,775	6,067	4,902	3,619	2
Net interest margin .....	13.4%	13.7%	13.8%	13.0%	
Loan loss reserves .....	\$ 410,159	\$ 123,123	\$ 12,175	\$ --	\$
Reserves as a percent of 30-day plus receivables (3).....	147.7%	138.1%	351.1%	--	
Delinquency ratio (3)(4) .....	10.1%	7.6%	2.4%	--	
Loan loss reserve ratio .....	14.9%	10.4%	8.4%	--	
Net charge-off ratio (5) .....	14.5%	23.5%	52.7%	--	

- (1) Excluding the one-time, non-cash accounting impacts from the adoption of SFAS 133 in January 2001 for our interest rate derivative instruments, the adoption of Staff Accounting Bulletin No. 101 for our debt waiver products in March 2000, and the extinguishment of the Series B Preferred Stock and 12% Senior Notes and the cancellation of warrants in June 1999.
- (2) Book value is calculated assuming conversion of preferred stock.
- (3) Figures as of December 31, 2001 reflect the adoption of FFIEC guidelines on re-aging accounts effective January 1, 2001. Excluding the re-age impact the delinquency ratio as of December 31, 2001 was 9.9%.
- (4) Delinquency ratio represents credit card loans that were at least 30 days contractually past due at year-end as a percentage of year-end owned credit card loans.
- (5) Net charge-off ratio reflects actual principal amounts charged off, less recoveries, as a percentage of average credit card loans. The net charge-off ratio at December 31, 2001 reflects an additional write-off of \$5.0 million resulting from a change in charge-off policy to 120 days from 180 days for accounts that enter into a credit counseling or similar program and later become delinquent.

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of Operations

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Net income applicable to common stockholders for the year ended December 31, 2001 was \$211.0 million, or \$2.47 per diluted share, up from net income applicable to common stockholders of \$163.5 million, or \$2.11 per diluted share in 2000. The increase in net income results from an increase in net interest income and other operating income partially offset by increases in the provision for loan losses and other operating expenses.

The provision for loan losses was \$549.1 million in 2001 compared to \$388.2 million in 2000. The increase relates to the estimated required balance in the allowance for loan losses to cover future charge-offs inherent in our loan portfolio. Increased credit card loans, increased net principal charge-offs, recent delinquency and collection trends, and current economic conditions were factors considered by management in determining the necessary balance in the allowance for loan losses. The net principal charge-off rate was 14.5% in 2001 compared to 23.5% in 2000. The decrease in the net principal charge-off rate is due to run-off of our partially secured portfolio. The delinquency ratio was 10.1% in 2001 compared to 7.6% in 2000. Excluding the FFIEC guidelines on re-aging accounts adopted January 1, 2001, which required us to report an additional \$6.5 million in receivables as delinquent as of December 31, 2001, the delinquency ratio was 9.9% in 2001.

Other operating income increased \$220.7 million, or 24%, to \$1.1 billion for the year ended December 31, 2001. This increase was primarily due to an increase in net securitization and credit card servicing income of \$73.1 million to \$517.4 million in 2001 caused by higher finance charge and fee income and lower funding costs on our securitized loan portfolio. The increase in finance charge and fee income is a result of growth in securitized loans. The average investors' interests in loans securitized increased \$1.2 billion to \$6.7 billion in 2001, compared to \$5.5 billion in 2000. Enhancement services revenues increased 28% to \$340.1 million in 2001, up from \$266.2 million in 2000. These increases were primarily due to the growth in total credit card accounts, an increase in outstanding receivables in the securitized credit card loan portfolio, development of new third-party relationships and the creation of new products.

Other operating expenses increased to \$714.2 million in 2001, compared to \$594.4 million in 2000. This increase was primarily due to continued investments in our infrastructure in order to service the growth in our credit card loan portfolio, an increase in overall marketing expenditures and increased amortization on purchased portfolio premiums. Our operating efficiency ratio decreased to 31.1% in 2001 from 32.4% in 2000 due to increased economies of scale and management cost saving initiatives begun in the latter part of 2001.

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 "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2001. During 2001, \$1.2 million was recorded as a reduction to interest expense and a \$13.6 million gain was recognized as a result of

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recording derivatives that did not qualify for hedge accounting treatment at fair value and hedge ineffectiveness.

In September 2000, the Financial Accounting Standards Board issued SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," which replaces SFAS 125, and revises the accounting standards and disclosure requirements for securitizations and transfers of financial assets and collateral. It requires enterprises to recognize, upon transfer of financial assets, the financial and servicing assets it controls and the liabilities it has incurred, derecognize financial assets when control has been surrendered, and derecognize liabilities when extinguished. This statement is effective for transfers and servicing of financial assets and extinguishment of liabilities occurring after March 31, 2001. The recognition and reclassification of collateral and additional disclosures related to securitization transactions and collateral were effective for fiscal years ending after December 15, 2000. The adoption of the new standard did not have a material impact on our financial statements.

During the quarter ended March 31, 2000, we adopted Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," for our debt waiver products. This SAB formalized the accounting for services sold where the right to a full refund exists, requiring all companies to defer recognition of revenues until the cancellation period is complete. Previously, we recognized half of the revenues in the month billed and half in the following month. We now recognize all of the revenue the month following completion of the cancellation period. This change resulted in a one-time, non-cash net charge to earnings of \$3.4 million, which is reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2000. Because we have applied the provisions of this SAB to our membership programs since 1998, before the SEC formalized its guidance, we did not have to adjust our enhancement services revenues.

### Critical Accounting Policies

The Company's accounting policies are identified on pages 68 through 76 of this Report, the most significant of which is 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% and other programs as deemed necessary. We separately analyze the

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reserve requirement on each of these groups or portfolios. The impact on

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the allowance for loan losses for accounts in suspended status under our debt waiver benefits is included in vintage pool roll rate analysis.

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:

- o national and economic trends and business conditions, including the condition of various market segments;
- o 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;
- o trends in volume and the product pricing of accounts, including any concentrations of credit; and
- o 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.

### 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:

	At December 31,	
	2001	2000
	---	----
Annual discount rate (1) .....	15%	15%
Monthly payment rate .....	7%	7%
Weighted-average spread (2) .....	20%	16%
Annual principal, finance charge and fees		
default rate .....	18%	16%

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(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.

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At December 31, 2001, the sensitivity of the current fair value of the retained interests to immediate 10 percent changes are as follows:

	Impact on Fair Value (in millions) of a 10% Increase or Decrease -----
Annual discount rate .....	\$ 15
Monthly payment rate .....	1
Weighted-average spread .....	164
Annual principal, finance charge and fees default rate.....	183

As the sensitivity indicates, the value of the Company's retained interests on its balance sheet, as well as reported earnings, could differ significantly if different assumptions or conditions would prevail.

### 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 December 31, 2001 and 2000 were \$89.5 million and \$79.2 million, respectively. The most significant assumption used by the Company 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.

### Deferred revenue on Enhancement Services Products

Direct Merchants Bank offers various debt waiver products to its credit card customers. 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.



## Net Interest Income

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 2 provides an analysis of interest income and expense, net interest spread, net interest margin and average balance sheet data for the years ended December 31, 2001, 2000 and 1999.

Table 2: Analysis of Average Balances, Interest and Average Yields and Rates

(Dollars in thousands)	Year Ended December 31,			
	Average Balance	2001 Interest	Yield/ Rate	Average Balance
<b>Assets:</b>				
Interest-earning assets:				
Federal funds sold .....	\$ 63,981	\$ 3,115	4.9%	\$ 144,780
Short-term investments .....	286,221	12,372	4.3%	78,697
Credit card loans and retained interests in loans securitized .....	3,605,126	681,503	18.9%	2,484,292
Total interest-earning assets .....	\$ 3,955,328	\$ 696,990	17.6%	\$ 2,707,769
Other assets .....	796,511	--	--	814,053
Allowance for loan losses and retained interest valuation allowance.....	(847,993)	--	--	(695,169)
Total assets .....	\$ 3,903,846	--	--	\$ 2,826,653
<b>Liabilities and Equity:</b>				
Interest-bearing liabilities:				
Deposits .....	\$ 2,110,967	\$ 127,918	6.1%	\$ 1,317,718
Debt .....	379,159	38,362	10.1%	354,204
Total interest-bearing liabilities.....	\$ 2,490,126	\$ 166,280	6.7%	\$ 1,671,922
Other liabilities .....	402,147	--	--	395,098
Total liabilities .....	2,892,273	--	--	2,067,020
Stockholders' equity .....	1,011,573	--	--	759,633
Total liabilities and equity .....	\$ 3,903,846	--	--	\$ 2,826,653
Net interest income and interest margin (1).....	--	\$ 530,710	13.4%	--
Net interest rate spread (2) .....	--	--	10.9%	--

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

(2) The net interest rate spread is the yield on average interest-earning

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assets minus the funding rate on average interest-bearing liabilities.

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Table 2: Analysis of Average Balances, Interest and Average Yields and Rates  
(continued)

(Dollars in thousands)	Year Ended December 31,		
	Average Balance	1999 Interest	Yield/ Rate
<b>Assets:</b>			
<b>Interest-earning assets:</b>			
Federal funds sold .....	\$ 90,748	\$ 4,477	4.9%
Short-term investments .....	45,708	2,298	5.0%
Credit card loans and retained interests in loans securitized .....	1,167,072	229,394	19.7%
<b>Total interest-earning assets .....</b>	<b>\$ 1,303,528</b>	<b>\$ 236,169</b>	<b>18.1%</b>
Other assets .....	651,227	--	--
Allowance for loan losses and retained interest valuation allowance .....	(505,458)	--	--
<b>Total assets .....</b>	<b>\$ 1,449,297</b>	<b>--</b>	<b>--</b>
<b>Liabilities and Equity:</b>			
<b>Interest-bearing liabilities:</b>			
Deposits .....	\$ 328,035	\$ 19,329	5.9%
Debt .....	323,260	36,512	11.3%
<b>Total interest-bearing liabilities .....</b>	<b>\$ 651,295</b>	<b>\$ 55,841</b>	<b>8.6%</b>
Other liabilities .....	255,952	--	--
<b>Total liabilities .....</b>	<b>907,247</b>	<b>--</b>	<b>--</b>
Stockholders' equity .....	542,050	--	--
<b>Total liabilities and equity .....</b>	<b>\$ 1,449,297</b>	<b>--</b>	<b>--</b>
<b>Net interest income and interest</b>			
margin (1) .....	--	\$ 180,328	13.8%
Net interest rate spread (2) .....	--	--	9.5%

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

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

Net interest income for the year ended December 31, 2001 was \$530.7 million, compared to \$371.8 million in 2000, an increase of \$158.9 million. This increase was primarily due to a \$1.1 billion increase in average loans and retained interests over the comparable period in 2000 offset by a decrease in net interest margins. The net interest margin decreased to 13.4% for the year

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ended December 31, 2001, from 13.7% for the year ended December 31, 2000. The decrease in net interest margin is primarily due to the fixed interest rates on Direct Merchants Bank's certificates of deposit used to fund variable rate credit card loans in a decreasing interest rate environment.

Net interest income is affected by changes in the average interest rate earned on interest-earning assets and the average interest rate paid on interest-bearing liabilities, in addition to changes in the volume of interest-earning assets and interest-bearing liabilities. Table 3 presents the effects of changes in average volume and interest rates on individual financial statement line items on an owned basis.

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Risk-Based Pricing

We price credit card offers based on a prospect's risk profile prior to solicitation or upon receipt of a completed application. We evaluate a prospect to determine credit needs, credit risk, and existing credit availability and then develop a customized offer that includes the most appropriate product, brand, pricing and credit line. After customers open credit card accounts, we periodically monitor customers' internal and external credit performance and periodically recalculate behavior, revenue, attrition and bankruptcy predictors. We re-evaluate customers' risk profiles on a regular basis, and the lending relationship can evolve to include more competitive (or more restrictive) pricing and product configurations. In our analyses, we consider the overall profitability of accounts, using both credit information and the profitability from selling enhancement services to customers.

Table 3: Changes in Net Interest Income

(Dollars in thousands)	Year Ended December 31, 2001 vs. 2000			Year Ended December 31, 2000 vs. 1999	
	Increase (Decrease)	Change due to* Volume	Rate	Increase	Change Volume
Interest Income:					
Federal funds sold .....	\$ (6,024)	\$ (4,273)	\$ (1,751)	\$ 4,662	\$ 3,173
Short-term investments .....	7,662	8,564	(902)	2,412	1,909
Credit card loans and retained interests in loans securitized	190,574	210,856	(20,282)	261,535	260,294
Total interest income .....	192,212	188,038	4,174	268,609	262,776
Deposit interest expense .....	38,358	46,785	(8,427)	70,231	66,832
Other interest expense .....	(5,084)	3,423	(8,507)	6,934	3,653
Total interest expense .....	33,274	49,434	(16,160)	77,165	80,927
Net interest income .....	\$ 158,938	\$ 138,604	\$ 20,334	\$ 191,444	\$ 181,849

\* The change in interest due to both volume and rates has been allocated in proportion to the relationship of the absolute dollar amounts of the change in

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each. We calculate changes in income and expense independently for each caption in the analysis. The totals for the volume and rate columns are not the sum of the individual lines.

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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 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 December 31, 2001, 33% of our outstanding receivables balance was from accounts that have been with us in excess of two years, and 22% 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, except in limited circumstances, until we charge off the account. In 2001, we adopted the FFIEC (Federal Financial Institutions Examination Council) guidelines with respect to credit card issuers that permitted 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 two times every 5 years. Prior to the implementation of these guidelines, credit card issuers were allowed to re-age accounts after receipt of only one minimum payment. The impact of the guidelines was an increase delinquent receivables by \$6.5 million as of December 31, 2001. Table 4 presents the delinquency trends of our credit card loan portfolio.

Table 4: Loan Delinquency

	December 31, 2001 ----	% of Total -----	December 31, 2000 ----	% of Total -----	December 31 1999 ----
(Dollars in thousands)					
Loan Portfolio ....	\$2,746,656	100%	\$1,179,203	100%	\$ 145,783
Loans contractually					
Delinquent:					
30 to 59 days ..	87,603	3.2%	27,837	2.4%	922
60 to 89 days ..	66,647	2.4%	22,074	1.9%	818
90 or more days	123,528	4.5%	39,257	3.3%	1,728

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Total .....	\$ 277,778	10.1%	\$ 89,168	7.6%	\$ 3,468
	=====	=====	=====	=====	=====

The 250 basis point increase during 2001 in the delinquency rates over 2000 primarily reflects seasoning in the portfolio, a deterioration in the economy and the adoption of FFIEC guidelines on re-aging accounts effective January 1, 2001, which required us to report an additional \$6.5 million of receivables as delinquent as of December 31, 2001. Without the impact of the FFIEC guidelines, the delinquency ratio was 9.9% as of December 31, 2001.

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Net charge-offs

Net charge-offs are the principal amount of losses from accountholders unwilling or unable to make minimum payments, bankrupt accountholders and deceased 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. During the quarter ended December 31, 2001 we changed our charge-off policy to 120 days from 180 days for accounts that enter into a credit counseling or similar program and later become delinquent. With the concurrence of regulatory authorities we concluded that these accounts should be treated as closed-end loans and charged off after 120 days under FFIEC policy. This change resulted in an additional write-off of \$5.0 million in 2001. During the quarter ended March 31, 2000, we changed our policy for partially secured card accounts to charge off accounts that are 120 days contractually delinquent rather than 180 days. This change was made based on our experience that secured card customers who are 120 days delinquent more closely resemble recovery accounts.

Table 5 presents our net charge-offs for the periods indicated as reported in the consolidated financial statements:

Table 5: Net Charge-offs

	Year Ended December 31,		
	2001	2000	1999
(Dollars in thousands)			
Average credit card loans			
outstanding .....	\$1,709,989	\$ 614,991	\$ 20,505
Net charge-offs .....	247,576	144,540	10,797
Net charge-off ratio .....	14.5%	23.5%	52.7%
	=====	=====	=====

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 existing loan portfolio.

The economy has slowed down significantly over the last year, exacerbated by the terrorist attacks on September 11, 2001. 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

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collections strategies to aggressively address any potential delinquency increases and utilizing our recovery staff to work on precharge-off receivables. We also leverage forbearance programs and credit counseling services for qualifying cardholders 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 forbearance programs was \$129.9 million or 5% of total credit card loans as of December 31, 2001. The amount of receivables in forbearance programs decreased to \$99.7 million as of February 28, 2002 as a result of tighter approval standards in our programs.

For purposes of assessing the adequacy of loan loss reserves, 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

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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% and other programs as deemed necessary. We separately analyze the reserve requirement on each of these groups or portfolios. The impact on the allowance for loan losses for accounts in suspended status under our debt waiver benefits is included in vintage pool roll rate analysis.

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:

- o national and economic trends and business conditions, including the condition of various market segments;
- o changes in lending policies and procedures, including those for underwriting, collection, charge-off and recovery, as well as in the experience, ability and depth of lending management and staff;
- o trends in volume and the product pricing of accounts, including any concentrations of credit; and
- o 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.

Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses maintained at Direct

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Merchants Bank (essentially those loans not sold via securitization or third-party conduit financing relationships). Such agencies may require that we recognize additions to the allowance based on their judgment about information available to them at the time of their examination. In determining the allowance for loan losses for credit card loans held by Direct Merchants Bank, we have taken into consideration the Office of the Comptroller of the Currency ("OCC") guidance for subprime lending programs. Under these guidelines, we are required to maintain an allowance for loan losses of at least twelve months' future charge-offs on all loans considered subprime (primarily those loans with a FICO score of 660 or below or with damaged credit histories).

The provision for loan losses for the year ended December 31, 2001, totaled \$549.1 million compared to a provision of \$388.2 million in 2000. The increase in the provision for loan losses in 2001 compared to 2000 reflects the growth in credit card loans, an increase in delinquencies and the current economic environment.

The allowance for loan losses was \$410 million as of December 31, 2001, versus \$123 million as of December 31, 2000. Our roll rate models indicated our required allowance for loan losses was in the range of \$380 million to \$410 million as of December 31, 2001, versus \$105 million to \$115 million as of December 31, 2000. The ratio of allowance for loan losses to period-end credit card loans was 14.9% at December 31, 2001 compared to 10.4% at December 31, 2000. The allowance for loan losses as a percentage of 30-day plus receivables was 147.7% at December 31, 2001 compared to 138.1% at December 31, 2000. The increase in the allowance as a percentage of loans and as a percentage of 30-day plus receivables reflects a deterioration in the economy and

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the impact of seasoning in the loan portfolio, which has caused higher delinquency levels in the loan portfolio.

We believe the allowance for loan losses is adequate to cover probable future losses inherent in the loan portfolio under current conditions. However, we cannot give assurance as to future credit losses that may be incurred in connection with our loan portfolio, nor can we provide assurance that the established allowance for loan losses will be sufficient to absorb future losses. During the past three years, annual net charge-offs have exceeded the beginning allowance for loan losses. This is primarily attributable to the following factors:

- o the allowance for loan losses takes into consideration losses inherent in the portfolio as of the balance sheet date and does not consider future growth in the portfolio (i.e., new accounts generated after the balance sheet date or new charges on existing accounts).
- o the impact of acquisitions, which occur subsequent to the balance sheet date.
- o the impact of reclassifying retained interests in loans securitized to credit card loans due to the maturing of bank conduits that were accounted for as a sale under FAS 140.

### Retained Interests Valuation

We determine the fair value of the 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

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rates, and a discount rate commensurate with the risk involved.

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 December 31, 2001, 2000 and 1999:

Table 6: Retained Interests in Loans Securitized

	2001 ----	Change -----	Year Ended December 31, 2000 ----	Change -----	
Gross retained interests.	\$ 1,263,655	\$ (760,026)	\$ 2,023,681	\$ 406,455	\$ 1,
Valuation allowance .....	(537,499)	103,353	(640,852)	(33,999)	(
	-----	-----	-----	-----	-----
Net retained interests ..	\$ 726,156	\$ (656,673)	\$ 1,382,829	\$ 372,456	\$ 1,
	=====	=====	=====	=====	=====

Gross retained interests in loans securitized decreased \$760.0 million to \$1.3 billion in 2001, compared to \$2.0 billion in 2000. In 2001, a bank conduit that was accounted for as a sale under SFAS 140 matured. As a result, approximately \$855 million of receivables that were classified as retained interests in loans securitized as of December 31, 2000 were classified as credit card loans in 2001. The decrease was offset by the retained interests on the growth in receivables funded through the Master Trust. The \$406.5 million increase in gross retained interests during 2000 reflects growth in our overall business, requiring increased funding in our Master Trust. During 2001, the valuation allowance decreased by \$103.4 million primarily due to the lower gross retained interests and the widening of excess spreads seen in the Master Trust. The projected weighted-average spread increased from 16% as of December 31, 2000 to 20% as of December 31, 2001. The increase in the projected weighted-average spread was due to lower cost of funds and the impact of interest rate floors on credit card accounts. The weighted-average spread less default rate was 2% as of December 31, 2001, compared to zero as of December 31, 2000. The projected default rate increased from 16% as of

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December 31, 2000 to 18% as of December 31, 2001. 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 approximate \$170 million increase in the valuation allowance, which was more than offset by the increase in the projected weighted-average spread and the decrease in the gross retained interests. During 2000, we recorded a \$34 million increase in the valuation allowance, which is primarily due to increases in the gross retained interests.

### Other Operating Income

Other operating income contributes substantially to our results of operations, representing 69% and 72% of total revenues for the years ended December 31, 2001 and 2000, respectively. Other operating income increased \$220.7 million for the year ended December 31, 2001 over 2000.

Net securitization and credit card servicing income increased \$73.1 million to \$517.4 million in 2001. The increase was primarily due to an increase in servicing revenue and the change in the retained interests valuation expense needed to record the retained interests at fair value. Servicing revenue



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increased approximately \$30 million to \$159 million for the year ended December 31, 2001 caused by an increase of approximately \$1.2 billion in average securitized receivables. The retained interests valuation expense decreased \$27.3 million for the year ended December 31, 2001 versus the year ended December 31, 2000.

Credit card fees, interchange and other credit card income was \$296.9 million in 2001, an increase of \$73.6 million over 2000. The increase is primarily the result of growth in our credit card portfolio and the retained interests in loans securitized. Average credit card loans and retained interests were \$3.6 billion in 2001 and \$2.5 billion in 2000.

Enhancement services revenues increased by \$73.9 million for the year ended December 31, 2001. This increase reflects higher credit protection revenue due to increased 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 year ended December 31, 2001 increased \$119.7 million over 2000, largely due to costs associated with the growth of our business activities. Employee compensation increased \$46.9 million for the year ended December 31, 2001, due to increased staffing needs. Credit card account and other product solicitation and marketing expenses increased \$30.4 million over 2000, largely due to increased marketing efforts which resulted in 1.2 million new credit card accounts and 3.5 million new enhancement relationships during 2001.

Enhancement services claims expenses increased \$9.2 million primarily driven by increased debt waiver claims. Debt waiver claims expenses were \$33.6 million in 2001 and \$23.7 million in 2000. The \$9.9 million increase relates to increased balances covered by debt waiver. As of December 31, 2001 we had a debt waiver total covered balance of \$2.7 billion, compared to \$2.1 billion as of December 31, 2000.

Purchased portfolio premium amortization increased \$11.0 million to \$30.3 million in 2001 compared to \$19.3 million in 2000. The increase relates to the amortization of premiums recognized on portfolio purchases late in 2000 and throughout 2001. Between August 25, 2000 and October 17, 2001, we purchased three portfolios with a total receivables balance of \$476 million and a premium of \$60.9 million.

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Other expenses increased \$18.0 million for the year primarily due to increased rent and depreciation related to the necessary investments in facilities and equipment to support and improve our business.

### Derivative Activities

We use derivative financial instruments for the purpose of managing our exposure to interest rate risks. We have a number of procedures in place to monitor and control both market and credit risk from these derivative activities. Our senior management approves all derivative strategies and transactions.

During 2001 and 2000, we entered into interest rate cap and interest rate swap transactions. We enter into interest rate caps through our subsidiary, Metris Receivables, Inc. ("MRI") on behalf of Master Trust investors. Interest

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rate caps are purchased on each of MRI's securitized debt issuances.

We entered into interest rate swap transactions through Direct Merchants Bank. The swaps are used to effectively convert a portion of the fixed rate certificates of deposit ("CDs") to variable rate CDs, and thus hedge the fair market value of the CDs. The CDs expose us to variability in the fair value in rising or declining interest rate environments. By converting the fixed payment to a variable payment, the interest rate swaps effectively reduce the variability of the fair market value of the CDs.

We account for these contracts in accordance with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138. We recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The change in the fair value of the derivatives are recognized currently in earnings unless specific hedge accounting criteria are met. If the derivative qualifies as a hedge, the accounting treatment for the change in fair value varies based on the type of risk being hedged. The monthly interest rate differential to be paid or received on these contracts is accrued and included in "Net securitization and credit card servicing income" or "Deposit interest expense," as appropriate, on the consolidated statements of income. Interest payable or receivable under these contracts are classified under "Other receivables due from credit card securitization, net" or "Other assets," as appropriate, on the consolidated balance sheets.

The adoption of SFAS 133 resulted in a one-time, non-cash, after-tax charge to earnings of \$14.5 million reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2001. During 2001, \$1.2 million was recorded as a reduction to interest expense and a \$13.6 million gain was recognized as a result of recording derivatives that did not qualify for hedge accounting treatment at fair value and hedge ineffectiveness.

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### Balance Sheet Analysis

#### Retained Interests in Loans Securitized

Retained interests in loans securitized decreased \$760.0 million to \$1.3 billion in 2001, compared to \$2.0 billion in 2000. In 2001, a securitization that was accounted for as a sale under SFAS 140 matured. As a result, approximately \$855 million of receivables that were classified as retained interests in loans securitized as of December 31, 2000 were classified as credit card loans in 2001. The decrease was offset by the required retained interests on the growth in receivables funded through the Master Trust.

#### Credit Card Loans

Credit card loans were \$2.7 billion as of December 31, 2001 compared to \$1.2 billion as of December 31, 2000. The \$1.5 billion increase is a result of the transfer of \$855 million of receivables from retained interests in loans securitized to credit card loans due to the maturity of the securitization previously discussed, the purchase of two credit card portfolios with approximately \$290 million of receivables and organic growth through increased marketing efforts.

#### Deferred Income Taxes

Total deferred tax assets, net of deferred tax liabilities, decreased from

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\$146.3 million as of December 31, 2000 to \$32.2 million as of December 31, 2001. The decrease in net assets resulted largely from a \$99.3 million increase in deferred tax liabilities, primarily related to accrued interest on credit card loans.

### Debt

Debt increased from \$356.1 million in 2000 to \$647.9 million in 2001 due to a warehouse financing arrangement entered into by Direct Merchants Bank in June 2001 that was accounted for as a collateralized financing. As of December 31, 2001 \$292.0 million was outstanding on the conduit and was used to fund credit card loans.

### Deferred Income

Deferred income decreased \$20.5 million to \$215.0 million as of December 31, 2001 compared to \$235.5 million as of December 31, 2000. The decrease primarily relates to our migration from annual billed to monthly billed products and lower product sales.

### Stockholders' Equity

Stockholders' equity was \$1.1 billion as of December 31, 2001, an increase of \$258.4 million over December 31, 2000 stockholders' equity of \$883.6 million. The increase results from net income of \$245.8 million and \$27.9 million stock issuances under employee benefit plans offset by cash dividends of \$3.8 million and \$13.0 million of stock repurchases under our stock repurchase program.

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## Item 7a. 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 that changes in interest rates have on the fair value of assets, net income and cash flow. We seek to minimize that impact 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 the Master Trust and bank-sponsored single-seller and multi-seller receivables conduits, which have committed funding primarily indexed to variable commercial paper rates and the London Interbank Offered Rate ("LIBOR"). Our \$270 million bank credit facility consists of a \$170 million revolving credit facility that is indexed to prime rate and a \$100 million term loan that is indexed to LIBOR. The subsidiary bank deposits are issued at fixed interest rates. The long-term debt is at fixed interest rates. At December 31, 2001, approximately 8.8% of the Master Trust and conduit funding of securitized receivables was funded with fixed rate securities, compared to 11.9% at December 31, 2000.

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In an interest rate environment with rates at or below current rates, at December 31, 2001, 91.2% of the securitization funding for the managed loan portfolio is indexed to floating commercial paper and LIBOR rates compared to 88.1% at December 31, 2000. In an interest rate environment with rates significantly above current rates, the potentially negative impact on earnings of higher interest expense is partially 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 December 31, 2001, a 200-basis-point increase in interest rates affecting our floating rate financial instruments, including both debt obligations and loans, would result in an increase in net income of approximately \$20 million relative to a base case over the next 12 months, compared to an approximate \$47 million increase as of December 31, 2000 relative to a base case over the next 12 months. A decrease of 200 basis points would result in a reduction in net income of approximately \$2 million as of December 31, 2001 and \$47 million as of December 31, 2000. The decrease in the sensitivity to changes in interest rates year over year is due to the impact of rate floors on our credit card receivables. 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 or the fact that LIBOR and prime rates may not move in tandem in an increasing or decreasing rate environment. 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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### 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. Liquidity management is a dynamic process, affected by changes in the characteristics of our assets and liabilities and short- and long-term interest rates. We use a variety of financing sources to manage liquidity, refunding, and interest rate risks. Table 7 summarizes our funding and liquidity as of December 31, 2001 and 2000:

Table 7: Liquidity, Funding and Capital Resources

(in thousands)	December 31, 2001		December 31, 2000	
	Outstanding	Unused Capacity	Outstanding	Unused Capacity
Bank conduit 2002 .....	\$ 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 .....	145,924	N/A	145,024	N/A
Other .....	9,980	N/A	11,042	N/A
Deposits .....	2,058,008	N/A	2,106,199	N/A

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Equity .....	1,141,955	N/A	883,553	N/A
	-----	-----	-----	-----
Subtotal .....	\$ 3,847,867	\$ 278,000	\$ 3,345,818	\$ 170,000
Off-balance sheet funding				
-----				
Metris Master Trust .....	\$ 7,880,342	\$ 328,908	\$ 5,857,224	\$ 344,991
Metris facility .....	15,500	59,500	--	75,000
Various conduits .....	--	--	213,000	687,000
	-----	-----	-----	-----
Subtotal .....	\$ 7,895,842	\$ 388,408	\$ 6,070,224	\$ 1,106,991
	-----	-----	-----	-----
Total .....	\$11,743,709	\$ 666,408	\$ 9,416,042	\$ 1,276,991
	=====	=====	=====	=====

Subsequent to December 31, 2001, we issued \$600 million of seven year, term asset-backed securities out of the Master Trust, and we created an \$850 million bank-sponsored conduit facility for additional funding capacity. Total unused capacity as of March 15, 2002 was \$2.1 billion.

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 \$662 million and a ratio of equity plus reserves to managed 90-day plus delinquencies of 2.25. As of December 31, 2001 and 2000 we were in compliance with all financial covenants under our credit agreements.

Our contractual cash obligations as of December 31, 2001 were as follows:

	Less than one year	One to three years	Four to five years	Over five years	Total
	-----	-----	-----	-----	-----
Long-term debt .....	\$ 292,497	\$ 200,910	\$ 154,479	\$ 18	\$ 647,9
Operating leases .....	16,650	23,818	17,333	34,301	92,1
Certificates of deposit.	1,216,757	567,897	273,354	--	2,058,0
Metris Master Trust ....	2,370,342	2,860,000	2,650,000	--	7,880,3
Metris facility .....	15,500	--	--	--	15,5
Open to buy on credit card accounts (1) ..	--	--	--	--	15,677,9
	-----	-----	-----	-----	-----
Total .....	\$3,911,746	\$3,652,625	\$3,095,166	\$ 34,319	\$26,371,8
	=====	=====	=====	=====	=====

(1) See tables on pages 9 - 11 for further information.

As previously noted, we utilize a variety of funding vehicles, as well as ongoing cash generated from operations, to finance receivables growth, maturing debt obligations and general operating needs. During the next year we intend to issue new asset back securities and increase the size of bank conduits to meet the cash obligations noted above. For example, subsequent to year-end the maturing long-term debt of \$292,497, the Metris facility of \$15,500 and a

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portion of the Metris Master Trust was refinanced on January, 30, 2002 with proceeds from the issuance of the \$600 million, seven- year asset-backed securities previously discussed. The remaining Metris Master Trust balances and the certificates of deposit will be refinanced through the issuance of new certificates of deposit, currently available conduit liquidity or by proceeds from the sale of receivables to the asset-backed market.

The weighted-average interest rate on outstanding funding as of December 31, 2001 and 2000 was as follows:

	December 31, 2001 -----	December 31, 2000 -----
Bank conduit 2002 ..	2.4%	--
Term loan 2003 .....	5.4%	9.9%
Senior notes 2004 ..	10.0%	10.0%
Senior notes 2006 ..	11.5%	11.6%
Other .....	8.9%	9.0%
Deposits .....	5.1%	7.0%
Equity .....	--	--
Metris Master Trust.	3.0%	7.3%
Metris facility ....	2.3%	--
Various conduits ...	--	7.6%

The 450-basis-point decrease in the weighted-average interest rate on the term loan and the 430 basis point decrease in the weighted-average interest rate on the Metris Master Trust was primarily due to the decrease in LIBOR, which is the base rate for these funding vehicles. As the base rate, LIBOR decreased from 6.6% as of December 31, 2000 to 1.9% as of December 31, 2001.

During 2001 and 2000, we had net proceeds of approximately \$1.8 billion and \$0.6 billion, respectively, from sales of credit card loans to the Master Trust and conduits. We used cash generated from these transactions to reduce borrowings and to fund credit card loan portfolio growth.

The following table presents the amounts, at December 31, 2001 of investor principal in securitized receivables scheduled to amortize in future years. We base the amortization amounts on estimated amortization periods, which are subject to change based on the Master Trust and conduit performance:

(in thousands)	
2002 .....	\$ 2,385,842
2003 .....	600,000
2004 .....	2,260,000
2005 .....	1,400,000
2006 .....	1,250,000
	-----
Total securitized loans at December 31, 2001 ....	\$ 7,895,842 =====

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The following table shows the annualized yields, defaults, costs and excess spreads for the Master Trust on a cash basis:

(In thousands)	2001 -----		2000 -----		
Gross yield .....	\$2,035,113	27.58%	\$1,528,056	27.22%	\$1,177,906

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Annual principal defaults.	972,348	13.18%	632,763	11.27%	483,921
	-----	-----	-----	-----	-----
Net portfolio yield .....	1,062,765	14.40%	895,293	15.95%	693,985
Annual interest expense, including					
servicing fee .....	451,061	6.62%	470,634	8.90%	339,004
	-----	-----	-----	-----	-----
Net excess spread .....	\$ 611,704	7.78%	\$ 424,659	7.05%	\$ 354,981
	=====	=====	=====	=====	=====

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 June 30, 2002 we have not broken any triggers in our securitization agreements and, therefore, no cash has been restricted.

The following table illustrates the amount of cash that would be restricted as additional collateral if the excess spread of the Master Trust was within various ranges for a one to three month period:

(In thousands)

Net Excess Spread	Restricted Cash
-----	-----
greater than 5.5%	\$ -
5.1% - 5.5%	56,409
4.6% - 5.0%	79,669
4.1% - 4.5%	181,239
3.6% - 4.0%	227,759
3.1% - 3.5%	274,278
less than 3.0%	350,468

In December 2001, the excess spread on our 1997-1 asset-backed securitization transaction, which had fixed-rate funding at 8.5%, dropped below the 4.5% trigger, requiring \$21.3 million in cash to be restricted by the Master Trust subsequent to year-end.

Direct Merchants Bank issues certificates of deposit of \$100,000 or more. As of December 31, 2001 and 2000, \$2.1 billion and \$2.1 billion of CDs were outstanding with original maturities ranging from six months to five years and three months to five years, respectively. These CDs pay fixed interest rates ranging from 2.4% to 7.6% and 5.4% to 7.6% at December 31, 2001 and 2000, respectively.

The Company's deposits and secured/unsecured debt are rated by Moody's Investor Services, Standard & Poor's Rating Services and Fitch, Inc. Factors affecting the various ratings include the overall health of the global/national economy, specific economic conditions impacting the subprime consumer finance industry and the overall financial performance of the Company, including earnings, credit losses, delinquencies, excess spreads in the Master Trust and

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overall Company liquidity. The table below illustrates the debt ratings MCI and Direct Merchants Bank as of December 31, 2001:

	Moody's -----	Standard & Poor's -----	Fitch -----
Metris Companies Inc.			
Senior unsecured debt.	Ba3	B+	BB
Credit facility .....	Ba3	BB-	BB+
Direct Merchants Bank ..	Ba1		
Short-term deposits ..			B
Long-term deposits ...			BB+

Subsequent to December 31, 2001, both Standard & Poor's Rating Services and Fitch, Inc. issued a negative outlook for the Company and its debt ratings, citing the current economic conditions and the overall financial condition of the consumer finance sector.

The Company has \$394.0 million of Series C Perpetual Convertible Preferred Stock outstanding which is held by affiliates of Thomas H. Lee Partners, L.P. (formerly the Thomas H. Lee Company) ("THL Partners"), a private equity firm, and is convertible into common shares at a conversion price of \$12.42 per common share subject to adjustment in certain circumstances. The Series C Preferred Stock has a 9% dividend payable in additional shares of Series C Preferred Stock and will also receive any cash dividends paid on the Company's common stock on a converted basis. One share of Series C Preferred Stock is convertible into 30 shares of common stock, plus a premium amount designed to guarantee a portion of seven years' worth of dividends at a 9% annual rate. For conversions in 2001, the premium amount would be equal to approximately 41% of those future dividends. Assuming conversion of the Series C Preferred Stock into common stock, THL Partners would own approximately 35% of the Company on a diluted basis at December 31, 2001. The Series C Preferred Stock entitles the holders to elect four members to MCI's Board of Directors. The Series C Preferred may be redeemed by us in certain circumstances by paying 103% of the redemption price of \$372.50 and any accrued dividends at the time of redemption. We also have the option to redeem the Series C Preferred Stock after December 9, 2008, without restriction by paying the redemption price of \$372.50 and any accrued dividends at the time of redemption.

The Federal Reserve Act imposes various legal limitations on the extent to which banks that are members of the Federal Reserve System can finance or otherwise supply funds to certain of their affiliates. In particular, Direct Merchants Bank is subject to certain restrictions on any extensions of credit to MCI or its subsidiaries. Additionally, Direct Merchants Bank is limited in its ability to declare dividends to MCI or its subsidiaries. Therefore, Direct Merchants Bank's investments in federal funds sold are generally not available for the general liquidity needs of the Company or its subsidiaries. These restrictions were not material to our operations at December 31, 2001 and 2000.

As the portfolio of credit card loans grows, or as the Master Trust and commercial paper conduit fundings amortize, our funding needs will increase accordingly. We believe that our cash flows from operations, asset securitizations, including commercial paper conduits, bank loans, subsidiary bank deposits, long-term debt and equity issuances will provide us with adequate liquidity for meeting anticipated cash needs, although no assurance can be given to that effect.



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Our equity as a percent of managed assets was 9.4% as of December 31, 2001 versus 9.0% as of December 31, 2000. We have historically retained cash flow generated from earnings (versus declaring larger dividends) to provide additional equity and liquidity to fund future receivables growth and operating expenditures. In addition, our 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 us in accordance with the national bank dividend provisions.

Direct Merchants Bank is subject to certain capital adequacy guidelines adopted by the OCC. At December 31, 2001 and 2000, 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 table below.

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:

As of December 31, 2001	Actual		For Capital Adequacy Purposes		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	-----	-----	-----	-----	-----	-----
Total Capital .....	\$346,907	13.0%	\$213,733	8.0%	\$267,166	10.0%

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(to risk-weighted assets)

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%

As of December 31, 2000	Actual		For Capital Adequacy Purposes		To Be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital .....	\$227,453	10.8%	\$167,255	8.0%	\$211,029	10.0%
(to risk-weighted assets)						
Tier 1 Capital .....	199,882	9.5%	83,135	4.0%	125,271	6.0%
(to risk-weighted assets)						
Tier 1 Capital ....	199,882	9.3%	84,833	4.0%	106,121	5.0%
(to average assets)						

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 guidelines, Direct Merchants Bank's total capital ratio as of December 31, 2001 was 8.5%.

Subsequent to December 31, 2001, we sold approximately \$610 million of receivables from Direct Merchants Bank to MCI. After selling these assets, Direct Merchants Bank's total capital ratio was 17.6% under normal capital adequacy guidelines and 11.3% under subprime guidelines, which are above minimum requirements.

Newly Issued Pronouncements

In July 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets", which establishes accounting and reporting standards for goodwill and other intangible assets. It requires

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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. SFAS 142 is effective for goodwill and intangible assets included on the balance sheet for all fiscal years beginning after December 15, 2001. The adoption of the new standard will not have a material impact on our financial statements.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The standard is effective for fiscal years beginning after December 15, 2001. The new rules on asset impairment supersede FASB Statement No. 121, and provide a single accounting model for long-lived assets to be disposed of. The adoption of the new standard will not have a material impact on our financial statements.

### Forward-Looking Statements

This Annual Report on Form 10-K/A 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 default and bankruptcy rates of our target market of moderate-income consumers, 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" on pages 26 through 32 of this Report. 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.

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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Net income applicable to common stockholders for the year ended December 31, 2000, was \$163.5 million, or \$2.11 per diluted share, up from net loss applicable to common stockholders of \$61.6 million, or \$1.07 per diluted share for 1999. Net loss applicable to common stockholders for the year ended December 31, 1999, included a \$152.4 million one-time, non-cash accounting impact from the issuance of the Series C Perpetual Convertible Preferred Stock, extinguishing the Series B Preferred Stock, the 12% Senior Notes, and the ten-year warrants reported in the second quarter 1999. Income before these extraordinary items for the year ended December 31, 1999, was \$115.4 million, or \$1.41 per diluted share. The increase in net income results from an increase in net interest income and other operating income partially offset by increases in the provision for loan losses and other operating expenses. These increases are largely attributable to the growth in average loans and active enhancement members.

The provision for loan losses was \$388.2 million in 2000, compared to \$174.8 million in 1999. The increase primarily reflects higher credit card loan balances and the addition of new credit card portfolios as well as an increase in net charge-offs. The reported net charge-off rate was 23.5% in 2000, compared to 52.7% in 1999.

Other operating income increased \$310.0 million, or 50%, to \$933.8 million for the year ended December 31, 2000. Net securitization and credit card servicing income increased \$125.4 million or 39% in 2000 from \$318.9 million in 1999. Credit card fees, interchange fees and other credit card income, increased to \$223.3 million for 2000, up 72% over \$129.8 million for 1999. In addition, enhancement services revenues increased 52% to \$266.2 million in 2000, up from \$175.1 million in 1999. These increases were primarily due to the growth in total credit card and enhancement services 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.

In December 1999, the Securities and Exchange Commission released SAB 101. This SAB formalized the accounting for services sold with a full refund, requiring all companies to defer recognition of service revenues until the cancellation period is complete. We adopted this practice for membership programs in 1998, before the official guidance was released. Due to the adoption of this SAB, we recorded a cumulative effect of change in accounting principle in the first quarter of 2000, with a net after-tax impact of \$3.4 million. This one-time, non-cash adjustment was to defer recognition of debt waiver revenue until the cancellation period is complete, which is one month. Prior to this change, we recognized one-half of the current period revenues in the month billed.

Other operating expenses increased to \$594.4 million in 2000, compared to \$438.0 million in 1999. This increase was due to continued investments in our infrastructure in order to service the growth in our managed credit card loan portfolio and our enhancement services members, as well as an increase in overall marketing expenditures. Our operating efficiency ratio increased to 32.4% in 2000 from 31.9% in 1999, due to the investment in infrastructure and marketing programs.

### 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

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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 the receivables that have been securitized and sold and own the right to the cash flows from those sold receivables in excess of interest 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 8: Selected Operating Data  
Managed Basis

Year Ended December 31,

(In thousands)	2001 ----	2000 ----	1999 ----	1998 ----
<b>Selected Operating Data:</b>				
Year-end loans .....	\$ 11,906,153	\$ 9,273,108	\$ 7,281,322	\$ 5,315,
Year-end assets .....	12,124,528	9,806,249	7,563,394	5,503,
Average loans .....	10,349,217	8,021,437	6,003,791	4,000,
Average interest-earning assets.	10,699,419	8,244,914	6,140,247	4,040,
Average assets .....	10,656,156	8,332,500	6,269,760	4,159,
Return on average assets (1) ...	2.4%	2.4%	1.8%	
Equity to managed assets .....	9.4%	9.0%	8.2%	
Net interest margin (2) .....	14.0%	13.0%	13.5%	1
Delinquency ratio (3) .....	9.4%	8.3%	7.6%	
Net charge-off ratio (4) .....	11.0%	9.7%	9.0%	1

(1) Excluding the one-time, non-cash accounting impacts from the adoption of SFAS 133 in January 2001 for our interest rate derivative instruments, the adoption of Staff Accounting Bulletin No. 101 for our debt waiver products in March 2000, and the extinguishment of the Series B Preferred Stock and 12% Senior Notes and the cancellation of warrants in June 1999.

(2) Includes MCI's actual cost of funds plus all costs associated with asset securitizations, including the interest expense paid to certificate holders and amortization of the discount and fees.

(3) Delinquency ratio represents credit card loans that were at least 30 days contractually past due at year-end as a percentage of year-end managed loans. Figures as of December 31, 2001 reflect the adoption of FFIEC guidelines on re-aging accounts effective January 1, 2001. Excluding the re-age impact the delinquency ratio as of December 31, 2001 was 9.1%.

(4) Net charge-off ratio reflects actual principal amounts charged off, less recoveries, as a percentage of average managed credit card loans. The net charge-off ratio at December 31, 2001 reflects an additional write-off of \$34 million resulting from a change in charge-off policy to 120 days from 180 days for accounts that enter into a credit counseling or similar program and later become delinquent.

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Table 9: Managed Loan Portfolio

	2001	% of Total	December 31, 2000	% of Total
	----	-----	----	-----
Credit card loans .....	\$ 2,746,656		\$ 1,179,203	
Retained interests in loans securitized .....	1,263,655		2,023,681	
Investors' interests in securitized loans accounted for as sales.....	7,895,842		6,070,224	
	-----		-----	
Total managed loan portfolio.....	\$11,906,153		\$ 9,273,108	
	=====		=====	
Loans contractually Delinquent:				
30 to 59 days .....	375,887	3.1%	228,238	2.5%
60 to 89 days .....	274,278	2.3%	173,531	1.9%
90 or more days .....	473,003	4.0%	365,963	3.9%
	-----	-----	-----	-----
Total .....	\$ 1,123,168	9.4%	\$ 767,732	8.3%
	=====	=====	=====	=====
Average balances:				
Credit card loans .....	\$ 1,709,989		\$ 614,991	
Retained interests in loans securitized .....	1,895,137		1,869,301	
Investors' interests in securitized loans accounted for as sales.....	6,744,091		5,537,145	
	-----		-----	
Total managed loan portfolio.....	\$10,349,217		\$8,021,437	
	=====		=====	
Net charge-offs .....	\$ 1,140,151	11.0%	\$ 778,921	9.7%
	=====	=====	=====	=====

The 110-basis-point increase during 2001 in the managed delinquency rates over 2000 primarily reflects seasoning in the portfolio, a deterioration in the economy and the adoption of FFIEC guidelines on re-aging accounts effective January 1, 2001, which required us to report an additional \$36.1 million of receivables as delinquent as of December 31, 2001. Without the impact of the FFIEC guidelines, the managed delinquency ratio was 9.1% as of December 31, 2001. We continue to focus our resources on collection efforts to minimize delinquency levels.

Managed net charge-offs increased \$361.2 million in 2001. We estimate that approximately \$225 million of the increase was due to growth in the portfolio, approximately \$100 million was the result of seasoning in the loan portfolio and deterioration in the economy and \$34 million was due to the change in our credit policy to charge-off after 120 days accounts that enter into credit counseling

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or similar program and later become delinquent.

Total managed loans increased \$2.6 billion to \$11.9 billion as of December 31, 2001, compared to \$9.3 billion as of December 31, 2000. This was primarily due to organic growth of the loan portfolio through increased marketing efforts, the credit line increase program and the purchase of two new credit card portfolios with approximately \$290 million of receivables.

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In June 2001, a securitization that was accounted for as a sale under SFAS 140 matured. As a result, approximately \$855 million of receivables that were classified as retained interests in loans securitized as of December 31, 2000 were classified as credit card loans as of December 31, 2001.

Table 10: Analysis of Average Balances, Interest and Average Yields and Rates

(Dollars in thousands)	Year Ended December			
	Average Balance	2001 Interest	Yield/Rate	Average Balance
Managed Basis				
Credit card loans .....	\$10,349,217	\$ 1,957,913	18.9%	\$ 8,021,43
Total interest-earning assets .....	10,699,419	1,973,400	18.4%	8,244,91
Total interest-bearing liabilities.....	9,234,217	480,465	5.2%	7,209,06
Net interest income and interest margin (1).....	--	1,492,935	14.0%	--
Net interest rate spread (2) .....	--	--	13.2%	--

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

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

Table 10: Analysis of Average Balances, Interest and Average Yields and Rates (continued)

(Dollars in thousands)	Year Ended December 31,		
	Average Balance	1999 Interest	Yield/Rate
Managed Basis			
Credit card loans .....	\$6,003,791	\$1,156,888	19.3%
Total interest-earnings assets.	6,140,247	1,163,663	19.0%
Total interest-bearing liabilities.....	5,488,015	335,417	6.1%
Net interest income and			

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Interest margin (1) .....	--	828,246	13.5%
Net interest rate spread (2) ..	--	--	12.9%

- (1) We compute net interest margin by dividing net interest income by average total interest-earning assets.
- (2) The net interest rate spread is the yield on average interest-earning assets minus the funding rate on average interest-bearing liabilities.

Managed net interest income for the year ended December 31, 2001 was \$1.5 billion, compared to \$1.1 billion in 2000, an increase of \$418.1 million. This increase was primarily due to a \$2.3 billion increase in average managed loans over the comparable period in 2000 and an increase in net interest margins. The net interest margin on managed interest-earning assets increased to 14.0% for the year ended December 31, 2001, from 13.0% for the year ended December 31, 2000. The increase in net interest margin is primarily due to lower average cost of funds. Cost of funds, primarily based on LIBOR rates, decreased to 5.2% in 2001 from 7.2% in 2000, partially offset by a decrease in portfolio yields to 18.9% in 2001 from 19.7% in 2000 because our credit card rates are based on the prime lending rate. Portfolio yields did not decrease at the same level as our cost of funds due to interest rate floors on some customer accounts as well as repricing initiatives taken early in 2001 due to the general deterioration in the economy and rising charge-off rates.

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### Item 8. Financial Statements and Supplementary Data

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

	December 31,	
	2001	2000
	----	----
<b>Assets:</b>		
Cash and due from banks .....	\$ 109,812	\$ 84,938
Federal funds sold .....	243,772	367,937
Short-term investments .....	134,502	68,565
	-----	-----
Cash and cash equivalents .....	488,086	521,440
	-----	-----
Retained interests in loans securitized .....	1,263,655	2,023,681
Less: Valuation allowance .....	537,499	640,852
	-----	-----
Net retained interests in loans securitized .....	726,156	1,382,829
	-----	-----
Credit card loans .....	2,746,656	1,179,203
Less: Allowance for loan losses .....	410,159	123,123
	-----	-----
Net credit card loans .....	2,336,497	1,056,080
	-----	-----
Property and equipment, net .....	114,913	128,395
Deferred income taxes .....	32,167	146,345
Purchased portfolio premium, net .....	94,793	95,537
Other receivables due from credit card securitizations, net.....	179,868	186,694
Other assets .....	256,206	218,705



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Total assets .....	\$ 4,228,686	\$3,736,025
	=====	=====
Liabilities:		
Deposits .....	\$ 2,058,008	\$2,106,199
Debt .....	647,904	356,066
Accounts payable .....	83,475	83,473
Deferred income .....	215,031	235,507
Accrued expenses and other liabilities .....	82,313	71,227
	-----	-----
Total liabilities .....	3,086,731	2,852,472
	-----	-----
Stockholders' Equity:		
Convertible preferred stock - Series C, par value \$.01 per share; 10,000,000 shares authorized, 1,057,638 and 967,573 shares issued and outstanding.....	393,970	360,421
Common stock, par value \$.01 per share; 300,000,000 shares authorized, 64,224,878 and 62,242,787 shares issued.....	642	622
Paid-in capital .....	232,413	198,077
Unearned compensation .....	(4,980)	--
Treasury stock - 806,300 shares .....	(13,014)	--
Retained earnings .....	532,924	324,433
	-----	-----
Total stockholders' equity .....	1,141,955	883,553
	-----	-----
Total liabilities and stockholders' equity ....	\$ 4,228,686	\$3,736,025
	=====	=====

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBSIDIARIES  
Consolidated Statements of Income  
(Dollars in thousands, except per-share data)

	Year Ended December 31,		
	2001	2000	1999
	----	----	----
Interest Income:			
Credit card loans and retained interests in loans securitized .....	\$ 681,503	\$ 490,929	\$ 229,394
Federal funds sold .....	3,115	9,139	4,477
Other .....	12,372	4,710	2,298
	-----	-----	-----
Total interest income .....	696,990	504,778	236,169
	-----	-----	-----
Deposit interest expense .....	127,918	89,560	19,329
Other interest expense .....	38,362	43,446	36,512
	-----	-----	-----
Total interest expense .....	166,280	133,006	55,841
	-----	-----	-----
Net Interest Income .....	530,710	371,772	180,328
Provision for loan losses .....	549,145	388,234	174,800
	-----	-----	-----

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Net Interest (Expense) Income			
After Provision for Loan Losses ...	(18,435)	(16,462)	5,528
	-----	-----	-----
Other Operating Income:			
Net securitization and credit card			
servicing income .....	517,399	444,254	318,873
Credit card fees, interchange			
and other credit card income .....	296,926	223,333	129,808
Enhancement services revenues .....	340,132	266,200	175,091
	-----	-----	-----
	1,154,457	933,787	623,772
	-----	-----	-----
Other Operating Expense:			
Credit card account and other product			
solicitation and marketing expenses.	174,883	144,481	107,726
Employee compensation .....	225,463	178,592	122,417
Data processing services and			
communications.....	90,222	86,166	65,970
Enhancement services claims expense .....	35,628	26,431	21,091
Credit card fraud losses .....	9,068	8,886	7,384
Purchased portfolio premium			
Amortization .....	30,277	19,275	31,752
Other .....	148,613	130,583	81,644
	-----	-----	-----
	714,154	594,414	437,984
	-----	-----	-----
Income Before Income Taxes,			
Extraordinary Loss and Cumulative			
Effect of Accounting			
Changes .....	421,868	322,911	191,316
Income taxes .....	161,577	124,320	75,953
	-----	-----	-----
Income Before Extraordinary Loss and			
Cumulative Effect of Accounting			
Changes .....	260,291	198,591	115,363
Extraordinary loss from early			
extinguishment of debt .....	--	--	50,808
Cumulative effect of accounting changes			
(net of income taxes of \$9,000 and			
\$2,180).....	14,499	3,438	--
	-----	-----	-----
Net Income .....	245,792	195,153	64,555
Preferred stock dividends-Series B .....	--	--	7,506
Convertible preferred stock			
dividends-Series C .....	34,771	31,624	17,080
Adjustment for the retirement of Series			
B preferred stock.....	--	--	101,615
	-----	-----	-----
Net Income (Loss) Applicable to			
Common Stockholders .....	\$ 211,021	\$ 163,529	\$ (61,646)
	=====	=====	=====

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Earnings per share:			
Basic-income (loss) before			
extraordinary loss and			
cumulative effect of accounting			
changes .....	\$ 2.67	\$ 2.23	\$ (0.19)
Basic-extraordinary loss .....	--	--	(0.88)

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Basic-cumulative effect of accounting changes .....	(0.15)	(0.04)	--
Basic-net income (loss) .....	2.52	2.19	(1.07)
Diluted-income (loss) before extraordinary loss and cumulative effect of accounting changes .....	2.62	2.15	(0.19)
Diluted-extraordinary loss .....	--	--	(0.88)
Diluted-cumulative effect of accounting changes .....	(0.15)	(0.04)	--
Diluted-net income (loss) .....	2.47	2.11	(1.07)
Shares used to compute earnings per share:			
Basic .....	97,641	89,234	57,855
Diluted .....	99,366	92,582	57,855
Dividends declared per common share .....	\$ 0.040	\$ 0.033	\$ 0.017

See accompanying Notes to Consolidated Financial Statements.

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METRIS COMPANIES INC. AND SUBS  
Consolidated Statements of Changes in St  
(Dollars and shares in thou

	Number of Shares		Preferred Stock	Common Stock	Paid-In Capital	Unearned Compensation	
	Preferred	Common					
BALANCE, DECEMBER 31, 1998 ...	540	57,779	\$ 201,100	\$193	\$ 107,615	\$ --	\$ --
Net income .....	--	--	--	--	--	--	--
Retirement of preferred stock - Series B ....	(560)	--	(208,606)	--	(101,615)	--	--
Issuance of preferred stock - Series C ....	840	--	312,910	--	122,369	--	--
Cash dividends .....	--	--	--	--	--	--	--
June 1999 two-for-one stock split .....	--	--	--	193	(193)	--	--
Preferred dividends in kind - Series B .....	20	--	7,506	--	--	--	--
Preferred dividends in kind - Series C .....	45	--	16,819	--	--	--	--
Issuance of common stock under employee benefit plans .....	--	140	--	--	2,596	--	--
BALANCE, DECEMBER 31, 1999 ...	885	57,919	\$ 329,729	\$386	\$ 130,772	\$ --	\$ --
Net income .....	--	--	--	--	--	--	--
Cash dividends .....	--	--	--	--	--	--	--
June 2000 three-for-two stock split .....	--	--	--	201	(201)	--	--
Preferred dividends in kind - Series C .....	83	--	30,692	--	--	--	--
Issuance of common stock under employee							

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benefit plans .....	--	4,324	--	35	67,506	--	--
BALANCE, DECEMBER 31, 2000 ...	968	62,243	\$ 360,421	\$622	\$ 198,077	\$ --	\$ --
Net income .....	--	--	--	--	--	--	--
Cash dividends .....	--	--	--	--	--	--	--
Common stock repurchased.	--	(806)	--	--	--	--	--
Preferred dividends in kind - Series C .....	90	--	33,549	--	--	--	--
Issuance of common stock under employee benefit plans .....	--	1,518	--	15	27,927	--	--
Deferred compensation obligations .....	--	464	--	5	6,409	(8,108)	--
Amortization of restricted stock ....	--	--	--	--	--	3,128	--
BALANCE, DECEMBER 31, 2001 ...	1,058	63,419	\$ 393,970	\$642	\$ 232,413	\$ (4,980)	\$ --

See accompanying Notes to Consolidated Financial St

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

		Year
		-----
		2001
		-----
Operating Activities:		
Net income .....	\$ 245,792	\$
Adjustments to reconcile net income to net cash provided by operating activities:		
Extraordinary loss from early extinguishment of debt.....	--	
Cumulative effect of accounting changes .....	14,499	
Depreciation and amortization .....	106,703	
Provision for loan losses .....	549,145	
Retained interests valuation expense (income).....	(131,992)	
Gains on derivative financial instruments .....	(10,129)	
Changes in operating assets and liabilities, net:		
Deferred income taxes .....	114,178	
Other receivables due from credit card securitizations .....	(14,354)	
Accounts payable and accrued expenses .....	6,446	
Deferred income .....	(20,476)	
Other .....	(62,507)	
Net cash provided by operating activities .....	797,305	
Investing Activities:		
Net proceeds from sales and repayments of securitized loans .....	1,854,257	
Net loans originated or collected .....	(2,632,577)	

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Credit card portfolio acquisitions .....	(290,774)	
Additions to premises and equipment .....	(5,706)	
	-----	-----
Net cash used in investing activities .....	(1,074,800)	(
	-----	-----
Financing Activities:		
Net increase in debt .....	291,838	
Net (decrease) increase in deposits .....	(48,191)	
Cash dividends paid .....	(3,752)	
Decrease in preferred equity .....	--	
Increase in common equity .....	17,260	
Repurchase of common stock .....	(13,014)	
	-----	-----
Net cash provided by financing activities .....	244,141	
	-----	-----
Net (decrease) increase in cash and cash equivalents.....		
		(33,354)
Cash and cash equivalents at beginning of year.....		521,440
		-----
Cash and cash equivalents at end of year .....	\$ 488,086	\$
	=====	=====

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Supplemental disclosures and cash flow information: Cash paid during the year for:

Interest .....	\$ 165,241	\$
Income taxes .....	25,718	
Tax benefit from employee stock option exercises.....	8,989	
Non-cash conversion of Senior Notes:		
Accrued expenses and other liabilities .....	--	
Debt .....	--	
Metris preferred stock .....	--	

See accompanying Notes to Consolidated Financial Statements.

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

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, National Association ("Direct Merchants Bank"), which may be referred to as "we," "us," "our" and the "Company." We are an information-based direct

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marketer of consumer lending products and enhancement services, primarily to moderate-income consumers. We issue credit cards through our wholly owned subsidiary, Direct Merchants Bank, the 10th largest bankcard issuer in the United States. We also offer consumers products through our enhancement services business unit, including credit card protection and insurance, extended service plans and membership clubs.

We have eliminated all significant intercompany balances and transactions in consolidation. We have reclassified certain prior-year amounts to conform with the current year's presentation. Included in these reclassifications is a change in our consolidated statement 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 an increase to cash flow used by investing activities by \$233.5 million and \$138.6 million for the years ended December 31, 2001 and 2000, respectively. The impact of this change was a decrease to cash flow provided by operating activities and a decrease to cash flow used by investing activities by \$15.5 million for the year ended December 31, 1999. These changes had no impact to the "Net change in cash and cash equivalents" on the consolidated statements of cash flows.

### 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, which is discussed under note 2, and our determination of the fair value of retained interests from assets securitized, which is discussed under note 17. 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 December 31, 2001 and 2000 could materially differ from these estimates.

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### NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting and reporting policies used in preparing the consolidated financial statements.

#### Federal Funds Sold and Short-term Investments

Federal funds sold are short-term loans made to banks through the Federal Reserve System. It is our policy to make such loans only to banks that are considered to be in compliance with their regulatory capital requirements. Short-term investments are investments in money market mutual funds and commercial paper with maturities less than three months.

#### Credit Card Loans

Credit card loans presented on our consolidated balance sheet are receivables from consumers that we have not sold via securitizations or third-party conduit warehousing arrangements, and are recorded at the principal amount outstanding. We accrue and earn interest income on credit card loans based on the principal amount of the loans outstanding using the effective-yield method. Accrued interest and fees which have been billed to the customer but not

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yet received are classified on the consolidated balance sheet with the related credit card loans. Accrued interest which has not yet been billed to the customer is estimated and classified on the consolidated balance sheet in "Other assets." Interest income and fees are generally recognized until a loan is charged off. A loan would be placed on non-accrual status prior to being charged-off if the cardholder is placed in a credit counseling or similar payment program, and as part of that program no interest or fees are being charged. At that time, the interest and fee portion of the charged-off balance is deducted from current period interest income and credit card fees.

### Securitization, Retained Interests in Loans Securitized and Securitization Income

We publicly and privately securitize a significant portion of our credit card loans to investors through the Master Trust and third-party, single-seller and multi-seller receivables conduits. We have recorded these transactions in accordance with Statement of Financial Accounting Standards ("SFAS") No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." If the transaction qualifies as a sale under SFAS 140, we remove the applicable credit card loans from the consolidated balance sheet. We retain participating interests in the sold credit card loans under "Retained interests in loans securitized" on the consolidated balance sheets. Our retained interests in loans securitized are subordinate to the interests of investors in the Master Trust and conduit portfolios. Retained interests include contractual subordinated interests, excess transferor's interests and accrued finance charges on securitized loans. SFAS 140 also requires us to initially measure the related financial and servicing assets controlled and liabilities incurred at fair value, if practicable, by allocating the previous carrying amount between the assets sold, if any, and retained interests, if any, based on their relative fair values at the date of the transfer.

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

Accounting for a securitization as a sale of credit card loans changes our interest in such loans from lender to servicer and investor, with a corresponding change in how revenue is reported in the consolidated statements of income. Amounts that otherwise would have been recorded as interest income, interest expense, fee income and provision for loan losses are instead reported in other operating income as "Net securitization and credit card servicing income." We have various receivables from the Master Trust or conduits and other assets as a result of securitizations, including: amounts deposited in accounts held by the Master Trust for the benefit of the Master Trust's security holders; amounts due from interest rate caps and floors; accrued and unbilled finance charges on the securitized receivables; servicing fee receivables and various other receivables. These amounts are reported as "Other receivables due from credit card securitizations, net" on the consolidated balance sheets.

### 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.

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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% and other programs as deemed necessary. We separately analyze the reserve requirement on each of these groups or portfolios. The impact on the allowance for loan losses for accounts in suspended status under our debt waiver benefits is included in vintage pool roll rate analysis.

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

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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:

- o national and economic trends and business conditions, including the condition of various market segments;
- o changes in lending policies and procedures, including those for underwriting, collection, charge-off and recovery, as well as in the experience, ability and depth of lending management and staff;
- o trends in volume and the product pricing of accounts, including any concentrations of credit; and
- o 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.

Various regulatory agencies, as an integral part of their examination process, periodically review our allowance for loan losses maintained at Direct Merchants Bank (essentially those loans not sold via securitization or third-party conduit financing relationships). Such agencies may require that we recognize additions to the allowance based on their judgment on information available to them at the time of their examination. In our opinion, the allowance for loan losses is adequate to cover probable losses inherent in the loan portfolio under current conditions.

We charge off most unsecured credit card accounts at the end of the month during which the loan becomes contractually 180 days past due. We charge off all partially secured credit card accounts and accounts which enter into credit counseling or other similar programs and later become delinquent at the end of the month during which the loan becomes contractually 120 days past due.



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Bankrupt accounts are charged off upon formal notification of bankruptcy. Accounts of deceased accountholders without a surviving, contractually liable individual, or an estate large enough to pay the debt in full are charged off immediately upon notification.

### Property and Equipment

We state property and equipment and computer hardware and software at cost and depreciate them on a straight-line basis over their estimated economic useful lives, which range from one to twenty-five years. We capitalize software developed for internal use that represents major enhancements or replacements of operating and management information systems. We begin amortization of such capitalized software when the systems are fully developed and ready for implementation. We expense repair and maintenance costs as incurred.

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### Purchased Portfolio Premium

The purchased portfolio premium represents the excess of amounts paid for portfolio acquisitions over the related credit card loan balances net of reserves and discounts. The premium is amortized over the estimated account life, generally seven years, using an effective-yield method. The recoverability of the premium is evaluated if events or circumstances indicate a possible inability to realize the carrying amount. Such evaluation is based on various analyses, including undiscounted cash flow projections.

### Enhancement Services

#### Debt Waiver Products

Direct Merchants Bank offers various debt waiver products on receivables owned by the Bank as well as securitized receivables. The Bank records deferred revenue when the debt waiver customer is billed. Revenue is recognized in the month following the completion of the cancellation period, generally one month. The Bank incurs the related claims and marketing expenses. A reserve is maintained at the Bank for future death and finance charge claims based on Direct Merchants Bank's historical experience with settlement of such claims. Revenues recorded for debt waiver products are included in the consolidated statements of income under "Enhancement services revenues" and were \$198.2 million, \$144.7 million and \$106.0 million for the years ended December 31, 2001, 2000 and 1999, respectively. Unearned revenues and reserves for pending claims are recorded in the consolidated balance sheets in "Deferred income" and "Accrued expenses and other liabilities," respectively. Unearned revenues as of December 31, 2001 were \$20.4 million compared to \$13.3 million as of December 31, 2000. Reserves for pending claims were \$5.2 million as of December 31, 2001 and \$4.0 million as of December 31, 2000.

During the quarter ended March 31, 2000 we adopted Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements," for our debt waiver products. This SAB formalized the accounting for services sold where the right to a full refund exists, requiring all companies to defer recognition of revenues until the cancellation period is complete. Previously, we recognized half of the revenues in the month billed and half in the following month. We now recognize all of the revenue in the month following completion of the cancellation period. This change resulted in a one-time, non-cash net charge to earnings of \$3.4 million, which is reflected as a "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2000. Because we have applied the provisions of this SAB to our membership programs since 1998, before the SEC formalized its guidance, we did not have to adjust our enhancement services revenues.

Membership Programs

We generally bill membership fees for enhancement services products through financial institutions, including Direct Merchants Bank, and other cardholder-based institutions. We record these fees as deferred membership 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. Revenues recorded for

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membership products are included in the statements of income under "Enhancement services revenues" and were \$94.7 million, \$76.0 million and \$31.9 million for the years ended December 31, 2001, 2000 and 1999, respectively.

In accordance with the provisions of Statement of Position 93-7, "Reporting on Advertising Costs," qualifying membership acquisition costs are deferred and charged to expense as membership fees are recognized. These costs, which relate directly to membership solicitations (direct response advertising costs), principally include: postage, printing, mailings and telemarketing costs. We amortize these costs on a straight-line basis as we realize revenues over the membership period. Amortization of membership acquisition costs amounted to \$23.7 million, \$14.9 million and \$9.9 million for the years ended December 31, 2001, 2000 and 1999, respectively. If deferred membership acquisition costs were to exceed forecasted future net revenues, we would make an appropriate adjustment for impairment. All other membership acquisition costs are expensed as incurred. Deferred membership acquisition costs amounted to \$69.9 million and \$59.3 million as of December 31, 2001 and 2000, respectively.

Extended Service Plans

We coordinate the marketing activities for third-party sales of extended service plans. We perform administrative services and retain the claims risk for all extended service plans sold. As a result, 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. The provision for service contract returns charged against deferred income for the years ended December 31, 2001, 2000 and 1999, amounted to \$0.2 million, \$3.0 million and \$5.0 million, respectively.

We discontinue the billing of enhancement services products to customers that are more than 60 days past due (except for debt waiver which bills customers until 120 days past due) or over their credit limit. The impact of uncollectible fees associated with enhancement service products is included in determining the adequacy of the allowance for loan losses and the retained interests valuation allowance.

Credit Card Fees and Origination Costs

Credit card fees include annual membership, late payment, overlimit, returned check, cash advance transaction and other miscellaneous fees. We assess these fees according to the terms of the related cardholder agreements and, except for annual membership fees, are recognized as revenue when charged to the cardholder's account.

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

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underwriting and the preparation and processing of loan documents. These deferred credit card origination costs and annual membership fees are amortized on a straight-line basis over the cardholder's privilege period, generally 12 months. Net deferred fees

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were \$4.2 million and \$13.1 million as of December 31, 2001 and 2000, respectively.

### Solicitation Expenses

We generally expense credit card account costs, including printing, credit bureaus, list processing costs, telemarketing and postage, as incurred over the two- to three-month period during which the related responses to such solicitation are received.

### Credit Card Fraud Losses

We experience credit card fraud losses from the unauthorized use of credit cards. We expense these fraudulent transactions when identified, through the establishment of a reserve for the transactions. We charge off these amounts after 90 days, after all attempts to recover the amounts from these transactions, including chargebacks to merchants and claims against cardholders, are exhausted.

### Interest Rate Risk Management Contracts

We enter into a variety of interest rate risk management contracts such as interest rate swap, floor and cap agreements with highly rated counterparties in order to hedge our interest rate exposure on securitized loans and deposits. We account for these contracts in accordance with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138. We recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. The change in the fair value of the derivatives are recognized currently in earnings unless specific hedge accounting criteria are met. If the derivative qualifies as a hedge, the accounting treatment for the change in fair value varies based on the type of risk being hedged. The monthly interest rate differential to be paid or received on these contracts is accrued and included in "Net securitization and credit card servicing income" or "Deposit interest expense," as appropriate, on the consolidated statements of income. Interest payable or receivable under these contracts is classified under "Other receivables due from credit card securitization, net" or "Other assets," as appropriate on the consolidated balance sheets.

### Debt Issuance Costs

Debt issuance costs are the costs related to issuing new debt securities and establishing new securitizations under the Metris Master Trust ("Master Trust") or conduits. We capitalize the costs as incurred and amortize them to expense over the term of the new debt security.

### Income Taxes

Deferred taxes are based on the temporary differences between the financial statement and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred taxes are based on the enacted rate that is expected to apply when the temporary differences reverse. A valuation allowance is recognized if it is more likely than not that all or some portion of the deferred tax asset will not be realized.

## Earnings Per Share

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

	Year Ended December 31,		
	2001	2000	1999
	-----	-----	-----
(In thousands)			
Income before extraordinary loss and cumulative effect of accounting changes .....	\$260,291	\$198,591	\$ 115,363
Preferred dividends - Series B .....	--	--	7,506
Preferred dividends - Series C .....	34,771	31,624	17,080
Adjustment for the retirement of Series B preferred stock .....	--	--	101,615
	-----	-----	-----
Net income (loss) applicable to common stockholders before extraordinary loss and cumulative effect of accounting changes .....	225,520	166,967	(10,838)
Extraordinary loss from the early extinguishment of debt .....	--	--	50,808
Cumulative effect of accounting changes, net. ....	14,499	3,438	--
	-----	-----	-----
Net income (loss) applicable to common stockholders .....	\$211,021	\$163,529	\$ (61,646)
	=====	=====	=====
Weighted average common shares outstanding ..	62,962	60,070	57,855
Adjustments for dilutive securities:			
Assumed conversion of convertible preferred stock .....	34,679	29,164	--(1)
	-----	-----	-----
Basic common shares(2) .....	97,641	89,234	57,855
Assumed exercise of outstanding stock options .....	1,725	3,348	--(1)
	-----	-----	-----
Diluted common shares .....	99,366	92,582	57,855
	=====	=====	=====

- (1) For the year ended December 31, 1999, there were convertible preferred stock and options outstanding to purchase 15.3 million and 3.2 million common shares. These potential common shares have been excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive.
- (2) In accordance with EITF Topic No. D-95, we revised our computation of basic earnings per common share. As required by Topic D-95, the dilutive effect of our Series C Convertible Preferred Stock is included in the computation of basic EPS, using the if-converted method. The Series C Convertible Preferred Stock participates in dividends on an as-converted basis with our common stock. For all periods presented, there is no impact to diluted earnings per share. We restated the basic EPS amounts for the years ended December 31, 2000 and 1999 to be consistent with the revised methodology. Before the impact of Topic D-95, basic EPS would have been \$3.35, \$2.72 and

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\$(1.07) for the years ended December 31, 2001, 2000 and 1999, respectively.

Comprehensive Income

SFAS 130 "Reporting Comprehensive Income," does not apply to our current financial results and therefore, net income equals comprehensive income.

NOTE 3 - SECURITIZATION ACTIVITY

During 2001 and 2000, we sold credit card loans in securitization transactions. In those securitizations, we retained servicing responsibilities and subordinated interests. We receive annual servicing fees approximating two percent of the outstanding balance and rights to future cash flows arising after the investors in the securitization trust have received the return for which they contracted. The investors and the securitization trusts have no recourse to our other assets for failure of debtors to pay when due. Our retained interests are subordinate to investors' interests. Their value is subject to credit and interest rate risks on the transferred financial assets.

Securitization activity for the years ended December 31, 2001 and 2000, is as follows:

	December 31,	
	2001	2000
	----	----
Credit card loans .....	\$ 2,746,656	\$ 1,179,203
Retained interests in loans securitized .....	1,263,655	2,023,681
Investors' interests in loans securitized.....	7,895,842	6,070,224
	-----	-----
Total managed loans .....	11,906,153	9,273,108
Managed loans more than 30-days contractually delinquent.....	1,123,168	767,732
Managed loans charged off, net of recoveries.....	1,140,151	778,921
	For the years ended	December 31,
	2001	2000
	----	----
Cash flow to/from the Company:		
Net proceeds from sales and repayments of securitized loans .....	\$ 1,825,618	\$ 551,911
Proceeds from collections reinvested in previous credit card securitizations.....	4,181,887	3,858,146
Servicing fees received .....	147,518	119,572
Other cash flows received on retained interests .....	565,918	401,557
	-----	-----
Total .....	\$ 6,720,941	\$ 4,931,186
	=====	=====

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NOTE 4 - ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses is as follows:

	Year Ended December 31,		
	2001	2000	1999
Balance at beginning of year .....	\$ 123,123	\$ 12,175	--
Allowance related to assets acquired, net .	14,106	5,963	--
Allowance related to assets transferred to the Master Trust.....	(28,639)	(138,709)	(151,828)
Provision for loan losses .....	549,145	388,234	174,800
Loans charged off .....	(275,057)	(150,099)	(10,797)
Recoveries .....	27,481	5,559	--
Net loans charged off .....	(247,576)	(144,540)	(10,797)
Balance at end of year .....	\$ 410,159	\$ 123,123	\$ 12,175

During 2001, 2000 and 1999, we transferred \$28.6 million, \$138.7 million and \$151.8 million of allowance for credit card loan losses to the valuation allowance on our retained interests in loans securitized. These transfers relate to asset sales between Direct Merchants Bank and the Master Trust, changes in accounting treatment as a result of changes in our source of funding (i.e. collateralized borrowing versus sales treatment under SFAS 140 and 125) and the amount of allowance for loan losses and valuation allowance on the retained interests determined through our roll rate analysis and fair value calculation.

NOTE 5 - RETAINED INTERESTS

Activity in retained interests is as follows:

	2001	Year Ended December 31, Change	2000	Change	1999
Gross retained interests.	\$ 1,263,655	\$(760,026)	\$ 2,023,681	\$ 406,455	\$ 1,617,226
Valuation allowance .....	(537,499)	103,353	(640,852)	(33,999)	(606,851)
Net retained interests...	\$ 726,156	\$(656,673)	\$ 1,382,829	\$ 372,456	\$ 1,010,375

Activity in the valuation for retained interests is as follows:

	Year Ended December 31,	
	2001	2000
Balance at beginning of year .....	\$ 640,852	\$ 606,853
Allowance related to assets acquired, net .....	--	--
Allowance related to assets transferred		

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to the Master Trust .....	28,639	138,709
Retained interests valuation expense (income).....	(131,992)	(104,710)
	-----	-----
Balance at end of year .....	\$ 537,499	\$ 640,852
	=====	=====

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NOTE 6 - PROPERTY AND EQUIPMENT

The carrying value of property and equipment is as follows:

	At December 31,	
	2001	2000
	----	----
Furniture and equipment .....	\$ 46,865	\$ 46,416
Computer software and equipment .....	65,407	55,399
Construction in progress .....	1,842	6,842
Buildings and land .....	28,031	27,805
Leasehold improvements .....	18,561	18,537
	-----	-----
Total .....	\$160,706	\$154,999
Less: Accumulated depreciation and amortization.....	45,793	26,604
	-----	-----
Balance at end of year .....	\$114,913	\$128,395
	=====	=====

Depreciation and amortization expense for the years ended December 31, 2001, 2000 and 1999, was \$24.7 million, \$16.0 million and \$6.8 million, respectively.

NOTE 7 - PURCHASED PORTFOLIO PREMIUM

The carrying value of the purchased portfolio premium was \$94.8 million and \$95.5 million as of December 31, 2001 and 2000, net of accumulated amortization of \$94.0 million and \$63.7 million, respectively. Amortization expense for the years ended December 31, 2001, 2000 and 1999 was \$30.3 million, \$19.3 million, and \$31.8 million, respectively. The purchased portfolio premium is analyzed for impairment using the undiscounted cash flow method. As of December 31, 2001 and 2000 the purchased portfolio premium was not impaired.

NOTE 8 - PORTFOLIO ACQUISITIONS

In 2001, Direct Merchants Bank purchased two credit card portfolios that consisted of approximately 170,000 active accounts and approximately \$290 million in receivables. In 2000, Direct Merchants Bank purchased one credit card portfolio that had approximately 184,000 active accounts and approximately \$186 million in receivables.

NOTE 9 - CONVERTIBLE PREFERRED STOCK

Affiliates of Thomas H. Lee Partners, L.P. ("THL Partners"), a Boston-based investment firm, and its predecessor, Thomas H. Lee Company, hold 100% of the outstanding shares of our Series C Perpetual Convertible Preferred Stock. The

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Series C Preferred Stock has a 9% dividend payable in additional shares of Series C Preferred Stock and also receives any cash dividends paid on our common stock based on the number of shares of common stock into which the Preferred Stock would convert on the record date of the dividend. Each share of Series C Preferred Stock is convertible into 30 shares of common stock plus - if converted at the option of the holder before January 1, 2004 - a premium amount designed to guarantee a portion of seven years worth of dividends at the 9% annual rate. The premium amount would have been equal to 41.0% of those future

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dividends for conversions in 2001 and would be 54.4% of those dividends in 2002.

The Series C Preferred Stock is normally fully convertible into common stock. This would mean that upon conversion of their Preferred Stock, our Preferred Stockholders could have received 35,597,993 shares, or approximately 36.0%, of our outstanding common stock on a diluted basis as of December 31, 2001, and could receive 38,977,613 shares, or approximately 38.5%, of our outstanding common stock on a diluted basis as of March 15, 2002. However, the indenture that governs our 10% Senior Notes due 2004 requires us to offer to purchase those notes in the event that such a conversion would result in a shareholder or group (within the meaning of Rules 13d-3 and 13d-5 of the Securities Exchange Act of 1934) obtaining 35% or more of our outstanding voting stock. Therefore, we included a provision in the terms of our Series C Preferred Stock that sets the maximum percentage of outstanding voting stock that any shareholder or group, such as the affiliates of THL Partners, could obtain while any of our 10% Notes remain outstanding at 34.9%. Accordingly, as of December, 2001, the Series C Preferred Stock could have been converted into 33,998,592 shares, or 34.9%, of our common stock on a diluted basis, with the excess Series C Preferred Stock converting into 1,599,401 shares of nonvoting Series D Preferred Stock. As of March 15, 2002, the Series C Preferred Stock could have been converted into 33,359,130 shares - again, 34.9%, of our common stock on a diluted basis - and 5,618,483 shares of Series D Preferred Stock. The Series D Preferred Stock automatically converts into common stock on a share-for-share basis at the time that the conversion will not exceed the ownership limitations described above. The terms of our Series D Preferred Stock are essentially the same as the terms of our common stock, except that

- o the Series D Preferred Stock has a liquidation preference of \$.01 per share, and
- o is non-voting, except as required by law to preserve the powers, preferences or other rights of that class of stock.

So long as they or their affiliates own at least 25% of the originally issued Series C Preferred Stock (or any shares of common stock issued upon conversion thereof), the holders of a majority of the shares of Series C Preferred Stock are entitled to elect four of eleven directors of the Board. So long as they or their affiliates: (a) own any shares of Series C Preferred Stock (or any shares of common stock issued upon conversion thereof); and (b) are entitled to elect four directors, the Thomas H. Lee Equity Fund IV, L.P., which owns approximately 85% of our outstanding Series C Preferred Stock, has the right to appoint one of the four directors. So long as they or their affiliates own at least 10% but less than 25% of the originally issued Series C Preferred Stock (or any shares of common stock issued upon conversion thereof), the holders of a majority of the shares of Series C Preferred Stock are entitled to elect one director. The four directors who have been elected by the holders of our Series C Preferred Stock are all affiliates of THL Partners and, through such affiliation as well as actual ownership of Series C Preferred Stock, may be



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deemed to be the beneficial owners of approximately 97% of the common stock that would be issued upon conversion of our Series C and D Preferred Stock, both individually and in the aggregate. Those directors - C. Hunter Boll, Thomas M. Hagerty,

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David V. Harkins and Thomas H. Lee - were first appointed to the Board of Directors in June 1999 and re-elected for one-year terms in May of 2000, 2001 and 2002.

The Series C Preferred Stock may be redeemed by us in certain circumstances by paying 103% of the redemption price of \$372.50 and any accrued dividends at the time of redemption. We also have the option to redeem the Series C Preferred Stock after December 9, 2008, without restriction by paying the redemption price of \$372.50 and any accrued dividends at the time of redemption.

Prior to shareholder approval and the receipt of notice that there was no regulatory objection to the Series C Preferred Stock investment, THL Partners agreed to purchase \$200 million in Series B Perpetual Preferred Stock and \$100 million in 12% Senior Notes due 2006. We also issued THL Partners 7.5 million ten-year warrants to purchase shares of our common stock.

On March 12, 1999, shareholders approved the conversion of the Series B Preferred Stock and 12% Senior Notes into Series C Preferred Stock. On June 1, 1999, the Series B Preferred Stock and the 12% Senior Notes were extinguished, and the warrants were canceled causing a one-time, non-cash accounting adjustment. The excess of the fair value of the Series C Preferred Stock over the carrying value of the Series B Preferred Stock and the 12% Senior Notes at the time of the conversion was allocated to the 12% Senior Notes and the Series B Preferred Stock based upon their initial fair values. To arrive at net income applicable to common stockholders in the calculation of earnings per share, the amount allocated to the 12% Senior Notes was recognized as an extraordinary loss from the early extinguishment of debt in the amount of \$50.8 million and the amount allocated to the Series B Preferred Stock was recognized as a reduction of net income applicable to common stockholders in the amount of \$101.6 million. The extraordinary loss attributable to the 12% Senior Notes is not recorded net of taxes. These adjustments did not have an impact on total stockholders' equity.

Other than the arrangements and transactions discussed in this Note 9 and the payment of normal directors' fees (including equity-based compensation and reimbursement of reasonable expenses to the four directors elected by the holders of our Series C Preferred Stock), we have not engaged in any material transactions with affiliates of THL Partners.

### NOTE 10 - STOCK OPTIONS

We offer the Metris Companies Inc. Long-Term Incentive and Stock Option Plan, which permits a variety of stock-based grants and awards and gives us flexibility in tailoring our long-term compensation programs. In 2001, the Board of Directors recommended, and the shareholders approved, an increase in the number of shares reserved for issuance under the plan to 17.0 million shares of common stock for awards of stock options or other stock-based awards, subject to adjustment in certain circumstances. As of December 31, 2001, 1.3 million shares were available for grant. We do not provide loans to employees for the purchase of stock or the exercise of stock options.

The Compensation Committee has the authority to determine the exercise prices, vesting dates or conditions, expiration dates and other material conditions upon which options or awards may be exercised, except that the option price for Incentive Stock Options ("ISOs") may not be less than 100% of the fair market value of the common stock on the date of grant (and not less than 110% of the fair market value in the case of an ISO granted to any employee owning more than 10% of the common stock) and the terms of nonqualified stock options may not exceed 15 years from the date of grant (not more than 10 years for ISOs and five years for ISOs granted to any employee owning more than 10% of the common stock). Full- or part-time employees, consultants or independent contractors are eligible to receive nonqualified options and awards. Only full- or part-time employees are eligible to receive ISOs.

During 2001, 2000 and 1999, we granted 2.7 million, 4.2 million and 2.7 million options, respectively, to officers and employees.

We also issue restricted stock grants under the stock option plan to our executive officers. A total of 72,600 and 91,400 common shares were granted in 2001 and 2000, with an approximate aggregate market value of \$1.8 million and \$2.3 million at the time of the grant, respectively. The market value of these restricted shares at the date of grant is amortized into expense over a period not less than the restriction period. We recognized expense of \$1.4 million in 2001 and \$1.1 million in 2000 for these restricted shares. If the restrictions are removed, generally upon death, disability or retirement, the remaining unamortized market value of the restricted shares is expensed. Previous to 2001, restricted shares were unregistered, and therefore the related unearned compensation was recorded in "Accrued expenses and other liabilities" on the consolidated balance sheet. In 2001 restricted shares were registered and all unearned compensation was recorded as part of stockholders' equity.

We also offer the Metris Companies Inc. Non-Employee Director Stock Option Plan which provides up to 750,000 shares of common stock for awards of options, subject to adjustments in certain circumstances. During 2001, 2000 and 1999, we granted 75,000, 82,500 and 127,500 options, respectively. At December 31, 2001, 300,000 shares were available for grant.

We have adopted the disclosure-only provisions of SFAS No. 123 "Accounting for Stock-Based Compensation." Accordingly, we continue to account for stock-based compensation under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Under the guidelines of Opinion 25, compensation cost for stock-based employee compensation plans is recognized based on the difference, if any, between the quoted market price of the stock on the date of grant and the amount an employee must pay to acquire the stock.

Proforma information regarding net income and earnings per share is required by SFAS 123 and has been determined as if we accounted for our employee stock options under the fair value method of SFAS 123. The fair value of the options was estimated at the grant date using a Black-Scholes option pricing model. The fair value of the options is amortized to expense over the options' vesting periods. Our net earnings and earnings

per share would have been reduced to the pro forma amounts indicated below:

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	Year Ended December 31,		
	2001	2000	1999
Net income as reported .....	\$245,792	\$195,193	\$ 64,555
Net income pro forma .....	236,570	185,356	59,733
Diluted earnings (loss) per share as reported.....	2.47	2.11	(1.07)
Diluted earnings (loss) per share pro forma	2.38	2.00	(1.15)
Weighted-average assumptions in option valuation:			
Risk-free interest rates .....	4.90%	6.40%	5.30%
Dividend yields .....	0.20%	0.10%	0.10%
Stock volatility factor .....	52.2%	58.4%	55.4%
Expected life of options (in years) .....	6.0	6.0	6.0

The above pro forma amounts may not be representative of the effects on reported net earnings for future years.

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Information regarding our stock option plans for 2001, 2000 and 1999, is as follows:

	2001		Year Ended December 31, 2000	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Options outstanding, beginning of year .....	9,907,062	\$17.67	10,129,614	\$9.72
Options exercised .....	1,383,358	11.81	4,212,537	5.46
Options granted .....	2,832,838	25.01	4,348,685	24.78
Options canceled/ forfeited .....	752,406	27.06	358,700	22.64
Options outstanding, end of year .....	10,604,136	19.73	9,907,062	17.67
Weighted-average fair value of options granted during the year.....	--	12.17	--	13.47

The following table summarizes information about stock options outstanding

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at December 31, 2001:

Exercise Price -----	Number Outstanding at 12/31/01 -----	Options Outstanding -----		Options E -----
		Weighted- Average Remaining Contractual Life ----	Weighted- Average Exercise Price -----	
\$ 0.00-\$16.77 .....	3,568,727	6.8	\$10.57	2,389,133
\$17.10-\$24.42 .....	4,058,285	8.3	22.09	1,353,360
\$24.67-\$38.88 .....	2,977,124	8.9	27.51	203,237
	-----	---	-----	-----
	10,604,136	7.9	\$19.73	3,945,730
	=====	===	=====	=====

Employee Stock Purchase Plan

During the third quarter of 1999, we adopted the Metris Companies Inc. Employee Stock Purchase Plan ("ESPP"), whereby eligible employees may authorize payroll deductions of up to 15% of their salary to purchase shares of our common stock. Under the plan, shares of our common stock may be purchased at the end of each monthly offering period at 85% of the lower of the fair market value on the first or last day of the monthly offering period. Employees contributed \$2.3 million and \$2.0 million to purchase 121,658 and 100,624 shares of common stock under the ESPP for 2001 and 2000, respectively. We are authorized to issue up to 2.6 million shares of common stock to employees under the plan, and as of December 31, 2001, there were approximately 2.3 million shares available for future issuance.

Management Stock Purchase Plans

We provide management stock purchase plans, whereby any employee who is a Senior Vice President or higher and who participates in the Metris Management Incentive Bonus Plan is eligible to participate. Participants may elect to defer up to 50% of their bonus received under the Management Bonus Plan, which is credited to a stock purchase account as restricted stock units. We will make a match of \$1 for every \$3 contributed by the participant. The participant's contributions are vested immediately and our matching contributions vest after three years (two years for contributions made for the year of adoption). Employees contributed approximately \$1.9 million to purchase 75,512 restricted stock units under the plans for 2001. The restricted stock units convert to common stock when distributed from the plans. We are authorized to issue up to 900,000 shares of common stock to employees under the plans, and as of December 31, 2001, approximately 770,000 of the authorized shares were available for future issuance.

NOTE 11 - EMPLOYEE BENEFIT PLANS

We offer a defined contribution plan that is intended to qualify under section 401(k) of the Internal Revenue Code. The 401(k) Plan provides retirement benefits for eligible employees. Eligible employees may elect to contribute to

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the 401(k) Plan, and we match a portion of employee contributions and make discretionary contributions based upon our financial performance. For the years ended December 31, 2001, 2000 and 1999, we contributed \$2.0 million, \$1.4 million and \$1.8 million to the 401(k) Plan, respectively.

In 2000, the Company adopted a new Non-Qualified Deferred Compensation Plan for a select group of management or highly compensated employees. These employees are allowed to participate in the 401(k) Plan under the new Plan in 2001 and 2000, but were unable to participate in the 401(k) Plan under the previous Non-Qualified Deferred Compensation Plan in 1998. There was no Non-Qualified Preferred Compensation Plan in effect during 1999. The new Plan provides saving and investment opportunities to those individuals who elect to defer a portion of their salary. Participants in the prior Plan were allowed to transfer their balances to the new Plan. The Company matches a portion of the employee contribution and makes discretionary contributions based on the Company's financial performance. We contributed \$334.5 thousand and \$296.5 thousand to the Plan for the years ended December 31, 2001 and 2000, respectively.

### Supplemental Executive Retirement Plan

Our funded Supplemental Executive Retirement Plan ("SERP") provides officers and other members of senior management with supplemental retirement benefits in excess of limits imposed on qualified plans by federal tax law. The SERP is an account balance plan to which we will make annual contributions targeted to provide 60% of the average of the participant's final five years of salary and bonus with us. These benefits will be paid in 15 annual installments beginning the year after they become eligible to receive benefits. Participants are eligible to receive benefits upon leaving our employment if they are at least 65 years of age or at least age 55 with five years of plan participation, if a change of control occurs or in the event of death. We recognized \$0.7

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million and \$0.9 million of expense in 2001 and 2000, respectively, related to the SERP. Our liability was \$3.1 million and \$3.1 million at December 31, 2001 and 2000, respectively, for future payments under this plan. We calculate this expense and liability based on actuarial assumptions regarding years of participation, future investment returns and participants continuing in the SERP until age 65.

### NOTE 12 - INCOME TAXES

The components of the provision for income taxes consisted of the following:

	Year Ended December 31,		
	2001	2000	1999
	----	----	----
Current:			
Federal...	\$ 41,795	\$ 77,185	\$94,309
State ....	5,604	7,867	14,236
Deferred ....	114,178	39,268	(32,592)
	\$161,577	\$124,320	\$75,953
	=====	=====	=====

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A reconciliation of our effective income tax rate compared to the statutory federal income tax rate is as follows:

	Year Ended December 31, -----		
	2001 ----	2000 ----	1999 ----
Statutory federal income tax rate .....	35.0%	35.0%	35.0%
State income taxes, net of federal benefit.	1.5%	2.8%	3.2%
Other, net .....	1.8%	0.7%	1.5%
	----	----	----
Effective income tax rate .....	38.3%	38.5%	39.7%
	====	====	====

Our deferred tax assets and liabilities are as follows:

	At December 31, 2001                      2000 -----                      -----	
Deferred income tax assets resulting from future deductible temporary differences:		
Allowance for loan losses and retained interests valuation allowance .....	\$ 210,271	\$ 214,989
Deferred revenues .....	72,944	74,755
Other .....	31,632	18,800
	-----	-----
Total deferred tax assets .....	\$ 314,847	\$ 308,544
Deferred income tax liabilities resulting from future taxable temporary differences:		
Accrued interest on credit card loans .....	\$ 213,899	\$ 114,595
Deferred costs .....	37,524	30,701
Other .....	31,257	16,903
	-----	-----
Total deferred tax liabilities .....	\$ 282,680	\$ 162,199
Net deferred tax assets .....	\$ 32,167	\$ 146,345

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We believe, based on our history of operating earnings, expectations for operating earnings in the future, and the expected reversal of taxable temporary differences, earnings will be sufficient to fully utilize the deferred tax assets.

NOTE 13 - RELATED PARTY TRANSACTIONS

In the ordinary course of business, our executive officers may have credit card loans issued by us. Pursuant to our policy, such loans are issued on the same terms as those prevailing at the time for comparable loans with unrelated persons and do not involve more than the normal risk of collectibility.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Commitments to extend credit to consumers represent the unused credit limits on open credit card accounts. These commitments amounted to \$15.7

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billion, \$10.9 billion and \$9.7 billion as of December 31, 2001, 2000 and 1999, respectively. While these amounts represent the total lines of credit available to our customers, we have not experienced and do not anticipate that all of our customers will exercise their entire available line at any given point in time. We also have the right to increase, reduce, cancel, alter or amend the terms of these available lines of credit at any time.

We lease certain office facilities and equipment under various cancelable and non-cancelable operating lease agreements that provide for the payment of a proportionate share of property taxes, insurance and other maintenance expenses. These leases also may include scheduled rent increases and renewal options. Rental expense for these operating leases for the years ended December 31, 2001, 2000 and 1999, was \$21.8 million, \$18.1 million and \$11.1 million, respectively.

Future minimum lease commitments at December 31, 2001, under cancelable and non-cancelable operating leases are as follows:

2002	\$16,650
2003	12,545
2004	11,273
2005	9,513
2006	7,820
Thereafter	34,301
	-----
Total minimum lease payments	\$92,102
	=====

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 cardholders 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.

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Subsequent to year end, preliminary approval of a class action settlement was signed by the Court 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. Based on negotiations with plaintiffs council and our offer of a settlement in the amount of \$5.6 million, we recorded a \$5.6 million accrual during the third quarter of 2001 to reflect the proposed settlement. Under the terms of the settlement, which was approved by the court on May 30, 2002, we denied any wrongdoing or liability.

Direct Merchants Bank's activities as a credit card lender are subject to regular review and examination by federal regulators to assess compliance with various federal consumer protection laws. Regulators are authorized to impose penalties for violations of these laws and, in certain cases, to order Direct Merchants Bank to pay restitution to injured cardholders.

On May 3, 2001, Direct Merchants Bank entered into a consent order with the Office of the Comptroller of the Currency ("OCC"). The consent order required Direct Merchants Bank to pay approximately \$3.2 million in restitution to approximately 62,000 credit card customers who applied for and received a credit card in connection with a series of limited test marketing campaigns from March

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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 the non-monetary portion of Direct Merchants Bank's agreement with the OCC will not have a material adverse effect on the financial position of MCI or Direct Merchants Bank.

In May 2001, the OCC also indicated that it was considering whether or not to pursue an assessment of civil money penalties and gave Direct Merchants Bank the opportunity to provide information to the OCC bearing on whether imposing a penalty would be appropriate and the severity of any penalty. The statutory provisions pursuant to which a civil money penalty could be assessed give the OCC broad discretion in determining whether or not a penalty will be assessed and, if so, the amount of the penalty. Direct Merchants Bank, to date, has not incurred nor paid any civil money penalties. We have not made an accrual for civil money penalties because we believe the assessment of such penalties is not probable nor is the amount reasonably estimated.

### NOTE 15 - CAPITAL REQUIREMENTS AND RESTRICTED PAYMENTS

In the normal course of business, we enter into agreements, or are 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 us and our affiliates. Such restrictions limit Direct Merchants Bank's ability to lend to us and our affiliates. Additionally, Direct Merchants Bank is limited in its ability

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to declare dividends to us in accordance with the national bank dividend rules.

Direct Merchants Bank is subject to certain capital adequacy guidelines adopted by the OCC. At December 31, 2001 and 2000, 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.

We are also bound by restrictions set forth in the indentures related to the Senior Notes dated November 7, 1997, and July 15, 1999. Pursuant to those indentures, we may not make dividend payments in the event of a default or if all such restricted payments would exceed 25% of our aggregate cumulative net income.

### NOTE 16 - CONCENTRATIONS OF CREDIT RISK

A concentration of credit risk is defined as significant credit exposure with an individual or group engaged in similar activities or affected similarly by economic conditions. We are active in originating credit card loans throughout the United States, and no individual or group had a significant concentration of credit risk at December 31, 2001 or 2000. The following table details the geographic distribution of our retained, sold and managed credit



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card loans:

	Owned -----	Sold -----	Managed -----
At December 31, 2001 -----			
California .....	\$ 500,991	\$ 986,393	\$ 1,487,384
New York .....	337,213	663,933	1,001,146
Texas .....	324,492	638,887	963,379
Florida .....	291,935	574,787	866,722
Illinois .....	166,097	327,027	493,124
Ohio .....	162,897	320,724	483,621
Pennsylvania.....	137,282	270,292	407,574
All others .....	2,089,404	4,113,799	6,203,203
	-----	-----	-----
Total .....	\$4,010,311	\$7,895,842	\$11,906,153
	=====	=====	=====

	Owned -----	Sold -----	Managed -----
At December 31, 2000 -----			
California .....	\$ 404,947	\$ 765,909	\$1,170,856
Texas .....	273,187	516,701	789,888
New York .....	261,192	494,015	755,207
Florida .....	238,972	451,988	690,960
Ohio .....	129,958	245,801	375,759
Illinois .....	128,650	243,326	371,976
Pennsylvania .....	104,911	198,427	303,338
All others .....	1,661,067	3,154,057	4,815,124
	-----	-----	-----
Total .....	\$3,202,884	\$6,070,224	\$9,273,108
	=====	=====	=====

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We target our consumer lending products primarily to moderate-income consumers. Primary risks associated with lending to this market are that they may be more sensitive to future economic downturn, which may make them more likely to default on their obligations.

NOTE 17 - FAIR VALUE OF FINANCIAL INSTRUMENTS

We have estimated the fair value of our financial instruments in accordance with SFAS No. 107, "Disclosures About Fair Value of Financial Instruments." Financial instruments include both assets and liabilities, whether or not recognized in our consolidated balance sheets, for which it is practicable to estimate fair value. Additionally, certain intangible assets recorded on the consolidated balance sheets, such as purchased credit card relationships, and other intangible assets not recorded on the consolidated balance sheets (such as the value of the credit card relationships for originated loans and the franchise values of our various lines of business) are not considered financial instruments and, accordingly, are not valued for purposes of this disclosure. We believe there is substantial value associated with these assets based on current market conditions, including the purchase and sale of these assets. Accordingly, the aggregate estimated fair value amounts presented do not represent the entire

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underlying value of the Company.

Quoted market prices generally are not available for all of our financial instruments. Accordingly, in cases where quoted market prices are not available, fair values were estimated using present value and other valuation techniques that are significantly affected by the assumptions used, including the discount rate and estimated future cash flows. These assumptions are based on historical experience and assessments regarding the ultimate collectibility of assets and related interest, and estimates of product lives and repricing characteristics used in our asset/liability management process. These assumptions involve uncertainties and matters of judgment, and therefore, cannot be determined with precision. Thus, changes in these assumptions could significantly affect the fair-value estimates.

A description of the methods and assumptions used to estimate the fair value of each class of our financial instruments is as follows:

Cash and cash equivalents and accrued interest and fees receivable

The carrying amounts approximate fair value due to the short-term nature of these instruments.

Net credit card loans and retained interests

Credit card loans are originated with variable rates of interest that adjust with changing market interest rates. Thus, the carrying value of the credit card loans, less the allowance for loan losses, approximates fair value. This valuation does not include the value that relates to estimated cash flows generated from new loans from existing accountholders over the life of the accountholder relationship. Accordingly, the aggregate fair value of the credit card loans does not represent the underlying value of the established accountholder relationships.

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The fair value of the retained interests are estimated by discounting the expected future cash flows from the Master Trust and each of the conduits at rates which we believe to be consistent with those that would be used by an independent third party. However, because there is no active market for this, the fair values presented may not be indicative of the value negotiated in an actual sale. The future cash flows used to estimate fair value are limited to the securitized receivables that exist at year end and do not reflect the value associated with future receivables generated by accountholder activity.

Interest rate cap, floor and swap agreements

The fair values of interest rate cap, floor and swap agreements were obtained from dealer quoted prices. These values generally represent the estimated amounts we would receive or pay to terminate the agreements at the reporting dates, taking into consideration current interest rates and the current creditworthiness of the counterparties.

Other securitization assets

For other securitization assets, the carrying amount is a reasonable estimate of the fair value, due to their short-term nature.

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Debt

We make short-term borrowings with variable rates of interest that adjust with changing market interest rates. Thus, carrying value approximates fair value.

We obtain the fair value of long-term debt from quoted market yields, when available.

Deposits

The fair value for fixed rate certificates of deposit are estimated based on quoted market prices of comparable instruments.

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The estimated fair values of our financial instruments are summarized as follows:

	2001 ----	At December 31, -----		2000 ----
	Carrying Amount -----	Estimated Fair Value -----	Carrying Amount -----	
Cash and cash equivalents .....	\$ 488,086	\$ 488,086	\$ 521,440	\$
Accrued interest and fees receivable.....	38,657	38,657	30,531	
Credit card loans, net .....	2,336,497	2,336,497	1,056,080	
Securitization assets:				
Retained interest in loans securitized, net.....	726,156	726,156	1,382,829	
Interest rate cap agreements.....	27,321	27,321	39,365	
Other .....	152,547	152,547	147,329	
Interest rate swap agreements.....	3,293	3,293	--	
Debt .....	647,904	633,005	356,066	
Deposits .....	2,058,008	2,067,697	2,106,199	

For purposes of determining the fair value of the net 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 cashflows in our calculation. The significant assumptions used for estimating the fair value of the retained interests in loans securitized are as follows:

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	At December 31,	
	2001	2000
	----	----
Annual discount rate (1).....	15%	15%
Monthly payment rate .....	7%	7%
Weighted-average spread (2) .....	20%	16%
Annual principal, finance charge and fees default rate.....	18%	16%

(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.

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At December 31, 2001, the sensitivity of the current fair value of the retained interests to immediate 10 percent and 20 percent adverse changes are as follows (in millions):

	Impact on Fair Value	
	10% adverse change	20% adverse change
	-----	-----
Annual discount rate (1) .....	\$ 15	\$ 29
Monthly payment rate .....	1	1
Weighted-average spread (2).....	164	322
Annual principal, finance charge and fees default rate.....	183	359

The actual annual principal and finance charge default rates for loans securitized are as follows:

Year ended December 31, 2001 .....	15%
Year ended December 31, 2000 .....	14%

We believe these sensitivity analyses may not accurately reflect the potential impact on the asset values as they do not consider potential offsetting positive impacts that would occur in the portfolio.

NOTE 18 - DERIVATIVE FINANCIAL INSTRUMENTS

We use derivative financial instruments for the purpose of managing our exposure to interest rate risks. We have a number of procedures in place to monitor and control both market and credit risk from these derivative activities. Our senior management approves all derivative strategies and transactions.

During 2001 and 2000, we entered into interest rate cap and interest rate swap transactions. We enter into interest rate caps through our subsidiary, Metris Receivables, Inc. ("MRI") on behalf of Master Trust investors. Interest rate caps are purchased in connection with each of MRI's securitized debt issuances. The interest rate caps do not meet the criteria for hedge accounting treatment. The change in the fair value of the caps is included in the consolidated income statement under "Net securitization and credit card income."

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For the year ended December 31, 2001, excluding the cumulative effect of accounting change, we recognized income of \$10.1 million from the mark-to-market adjustments on the interest rate caps.

We entered into interest rate swap transactions through Direct Merchants Bank. The swaps are used to effectively convert the fixed rate certificates of deposit to variable rate certificates of deposit, and thus hedge the fair market value of the CDs. The CDs expose us to variability in the fair value in rising or declining interest rate environments. By converting the fixed payment to a variable payment, the interest rate swaps effectively reduce the variability of the fair market value of the CDs.

As of January 1, 2001, we had two outstanding interest rate swap agreements accounted for as hedges under SFAS 133 with a combined value of \$2.7 million. In February 2001, we entered into two additional swap agreements with no value as of the inception date. As of the adoption of SFAS 133 or their inception, all four swaps were designated as fair value

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hedges. Changes in the value of the swaps are recognized in income, in the period in which the change in value occurred. In addition, changes in the value of the CDs, to the extent they are attributable to the risk being hedged, are simultaneously recognized in income. Any difference between the fair value change in the swaps versus the fair value change in the related hedged CDs was considered to be the "ineffective" portion of the hedge. The ineffective portion of the swap is recorded as an increase or decrease in income.

During 2001, three of four swaps were sold. At the date of sale, the swap and the related CDs were valued, and a gain or loss was recognized for the difference between the change in fair value of the swap and the change in fair value of the CDs. The cumulative amount recorded as an adjustment to the value of the CDs is being amortized over the life of the CDs as an adjustment to interest expense. For the year ended December 31, 2001, approximately \$1.2 million of CD valuation adjustments were recorded as an offset to interest expense. The unamortized valuation adjustment as of December 31, 2001 was \$2.8 million, which will be recognized as an offset to interest expense in 2002. Additionally, \$3.5 million was recognized as income in 2001 related to the ineffective portion of the swaps.

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 "Cumulative effect of accounting change" in the consolidated statements of income for the year ended December 31, 2001. As of December 31, 2001, we had 13 interest rate caps valued at \$27.3 million and one interest rate swap valued at \$3.3 million.

The notional amounts and weighted-average interest rate of interest rate swap, cap and floor agreements purchased and sold during 2001 and 2000 are as follows:

Year Ended December 31, (Dollars in thousands)	2001	Weighted- Average Interest Rate	2000	Weighted- Average Interest Rate
	----	----	----	----
Interest rate swap agreements:				

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Beginning balance ...	\$ 249,000	7.0%	\$ --	--
Additions .....	171,300	6.8%	249,000	7.0%
Terminations .....	295,800	6.9%	--	--
	-----		-----	
Ending balance .....	\$ 124,500	7.0%	\$ 249,000	7.0%
	=====		=====	

### Interest rate caps:

Beginning balance .....	\$5,119,628	9.2%	\$4,213,021	9.4%
Additions .....	396,243	10.5%	1,260,774	8.5%
Terminations .....	1,053,294	9.5%	354,167	9.1%
	-----		-----	
Ending balance .....	\$4,462,577	9.2%	\$5,119,628	9.2%
	=====		=====	

### Interest rate floor:

Beginning balance ...	\$ --	--	\$ 58,333	6.2%
Additions .....	--	--	--	--
Terminations .....	--	--	58,333	6.2%
	-----		-----	
Ending balance .....	\$ --	--	\$ --	--
	=====		=====	

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### NOTE 19 - SEGMENTS

We operate in two principal areas: consumer lending products and enhancement services. Our consumer lending products are primarily unsecured and partially secured 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 customers and customers of third parties. We currently issue and administer our extended service plans sold through a third-party retailer, and the customer pays the retailer directly.

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 elimination column in the segment table includes adjustments to present the information on an owned basis as reported in the financial statements of this Annual Report on Form 10-K/A.

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 include these expenses in the reconciliation of the income before income taxes, extraordinary loss and cumulative effect of accounting changes for the reported segments to the consolidated total. We do not allocate capital expenditures for leasehold improvements, capitalized software and furniture and equipment to operating segments. There were no operating assets located outside of the United States

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for the periods presented.

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

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	2001				
	Consumer Lending Products -----	Enhancement Services -----	Securitization Adjustments (a) -----	Other Adjustments (b) -----	Consolidated -----
Interest income .....	\$ 1,973,400	\$ 12,308	\$ (1,276,410)	\$ (12,308)	\$ 696,992
Interest expense .....	492,773	--	(314,185)	(12,308)	166,280
Net interest income .....	1,480,627	12,308	(962,225)	--	530,710
Other revenue .	612,683	340,132	201,642	--	1,154,457
Total revenue .	2,093,310	352,440	(760,583)	--	1,685,167
Income before income taxes and cumulative effect of accounting change.....	684,663 (c)	231,780 (c)	--	(494,575)	421,868
Total assets ..	\$11,395,934	\$ 138,420	\$ (7,895,843)	\$ 590,175 (d)	\$ 4,228,686

	2000				
	Consumer Lending Products -----	Enhancement Services -----	Securitization Adjustments (a) -----	Other Adjustments (b) -----	Consolidated -----
Interest income ....	\$1,596,352	\$ 11,848	\$ (1,091,574)	\$ (11,848)	\$ 504,778

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Interest expense.....	533,325	--	(388,471)	(11,848)	133,006
Net interest income .....	1,063,027	11,848	(703,103)	--	371,772
Other revenue ..	494,155	266,200	173,432	--	933,787
Total revenue ..	1,557,182	278,048	(529,671)	--	1,305,559
Income before income taxes and cumulative effect of accounting change .....	560,772 (c)	176,756 (c)	--	(414,617)	322,911
Total assets ..	\$9,013,828	\$ 154,236	\$ (6,070,224)	\$ 638,185 (d)	\$ 3,736,025

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	Consumer Lending Products	Enhancement Services	Securitization Adjustments (a)	Other Adjustments (b)	Consolidated
Interest income .....	\$1,163,663	\$ 4,649	\$ (927,494)	\$ (4,649)	\$ 236
Interest expense.....	340,066	--	(279,576)	(4,649)	55
Net interest income .....	823,597	4,649	(647,918)	--	180
Other revenue ..	368,500	175,091	80,181	--	623
Total revenue ..	1,192,097	179,740	(567,737)	--	804
Income before income taxes and cumulative effect of accounting change .....	392,453 (c)	100,646 (c)	--	(301,783)	191
Total assets ...	\$7,190,903	\$ 116,106	\$ (5,518,312)	\$ 256,385 (d)	\$ 2,045

(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.



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

(c) Income before income taxes, extraordinary loss and cumulative effect of accounting changes, includes intercompany commissions paid by the enhancement services segment to the consumer lending products segment for successful marketing efforts to consumer lending products cardholders of \$12.4 million, \$18.3 million and \$6.7 million for 2001, 2000 and 1999, respectively.

(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.

### NOTE 20 - STOCKHOLDERS' EQUITY

On February 6, 2001, the Company's Board of Directors authorized a share repurchase program of up to \$200 million of its outstanding common stock over a period ending December 31, 2002. The amount of shares the Company can repurchase in a calendar year is limited under its various debt agreements. In 2001, the Company was limited to repurchasing approximately \$75 million of shares. As of December 31, 2001, 0.8 million shares had been repurchased under the program for \$13.0 million. Subsequent to December 31, 2001, we repurchased an additional 1.2 million shares for \$17.6 million.

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### NOTE 21 - DEBT AND DEPOSITS

A warehouse financing facility entered into in June 2001 has been accounted for as a collateralized financing under SFAS 140 and included in "Debt" on the consolidated balance sheet. The financing conduit has a capacity of \$400 million and a variable interest rate based on LIBOR. As of December 31, 2001, \$292 million was outstanding on the conduit. During July 2000, we amended and restated our credit facility. The amended credit facility consists of a \$170 million revolving credit facility which matures in July 2003 and a \$100 million term loan which matures in June 2003. At December 31, 2001 and 2000, we had outstanding borrowings of \$100 million under the term loan facility with weighted-average interest rates of 5.4% and 9.9%, respectively, and no outstanding balance on the revolving credit facility at December 31, 2001 and 2000. At December 31, 2001, we were in compliance with all financial covenants under these agreements.

As of December 31, 2001, we had \$145.9 million of 10.125% Senior Notes due 2006 outstanding. These Senior Notes were issued at a discount of \$6.3 million to yield an effective interest rate of 11%. The Senior Notes due 2006 and credit facility are unconditionally guaranteed on a senior basis, jointly and severally, by Metris Direct, Inc., magnUS Services, Inc. (formerly Metris Recovery Services, Inc.), Metris Card Services, LLC and Metris Credit Card Services, Inc. ("Guarantors"), and all of our future subsidiaries that guarantee any of our indebtedness. The guarantee is an unsecured obligation of the Guarantors and ranks equally with all existing and future unsubordinated indebtedness. We also have \$100 million of 10% Senior Notes due 2004 outstanding with terms and conditions substantially similar to the Senior Notes due 2006. We have a \$10.0 million 9.19% term loan due 2005 used to fund Company equipment.

Our debt outstanding as of December 31, 2001, matures as follows:

2002	\$292,497
------	-----------

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2003	100,434
2004	100,476
2005	8,543
2006	145,936
Thereafter	18
	-----
Total debt outstanding	\$ 647,904
	=====

Direct Merchants Bank issues certificates of deposit of \$100,000 or more. As of December 31, 2001 and 2000, \$2.1 billion and \$2.1 billion of CDs were outstanding with original maturities ranging from six months to five years and three months to five years, respectively. These CDs pay fixed interest rates ranging from 2.4% to 7.6% and 5.4% to 7.6% at December 31, 2001 and 2000, respectively.

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Our CDs outstanding as of December 31, 2001 and 2000, mature as follows:

	2001	Weighted- Average Interest Rate	2000	Weighted- Average Interest Rate
	----	----	----	----
Three months or less .	\$ 404,955	5.8%	\$ 384,795	6.1%
Over three months through twelve months .....	811,802	5.3%	1,214,288	6.6%
Over one year through three years .....	567,897	5.2%	467,652	7.7%
Over three years .....	273,354	5.9%	39,464	7.4%
	-----	---	-----	---
Total certificates of deposits .....	\$2,058,008	5.4%	\$2,106,199	6.8%
	=====	===	=====	===

We have various indirect subsidiaries which do not guarantee Company debt. We have prepared condensed consolidating financial statements of the Company, the Guarantor subsidiaries and the non-guarantor subsidiaries for purposes of complying with SEC reporting requirements. Separate financial statements of the guaranteeing subsidiaries and the non-guaranteeing subsidiaries are not presented because we have determined that the subsidiaries financial information would not be material to investors.

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

Metris                      Guarantor                      Non-Guarantor

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	Companies Inc.	Subsidiaries	Subsidiaries	Eliminations
	-----	-----	-----	-----
<b>Assets:</b>				
Cash and cash equivalents.....	\$ 17,613	\$ 1,505	\$ 468,968	\$ --
Net retained interests in loans securitized.....	--	--	726,156	--
Credit card loans .....	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)
<b>Total assets .....</b>	<b>\$ 1,898,293</b>	<b>\$ 1,882,006</b>	<b>\$ 4,100,874</b>	<b>\$ (3,652,487)</b>
<b>Liabilities:</b>				
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)	--
<b>Total liabilities .....</b>	<b>756,338</b>	<b>(18,522)</b>	<b>2,355,173</b>	<b>(6,258)</b>
<b>Total stockholders' equity.....</b>	<b>1,141,955</b>	<b>1,900,528</b>	<b>1,745,701</b>	<b>(3,646,229)</b>
<b>Total liabilities and stockholders' equity.....</b>	<b>\$ 1,898,293</b>	<b>\$ 1,882,006</b>	<b>\$ 4,100,874</b>	<b>\$ (3,652,487)</b>

METRIS COMPANIES INC.  
Supplemental Consolidating Balance Sheets  
December 31, 2000  
(Dollars in thousands)

Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
-----	-----	-----	-----	-----

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Assets:

Cash and cash equivalents .....	\$ 64,869	\$ 10,658	\$ 445,913	\$ --	\$ 521,4
Net retained interests in loans securitized .....	311	--	1,382,518	--	1,382,8
Credit card loans ...	2,232	--	1,053,848	--	1,056,0
Property and equipment, net ...	--	77,693	50,702	--	128,3
Deferred income taxes .....	(2,415)	17,104	131,656	--	146,3
Purchased portfolio premium .....	248	--	95,289	--	95,5
Other receivables due from credit card securitizations, net .....	14	84	186,596	--	186,6
Other assets .....	13,806	41,946	173,583	(10,630)	218,7
Investment in subsidiaries .....	1,588,918	1,442,295	--	(3,031,213)	
<b>Total assets .....</b>	<b>\$ 1,667,983</b>	<b>\$ 1,589,780</b>	<b>\$3,520,105</b>	<b>\$ (3,041,843)</b>	<b>\$3,736,0</b>
Liabilities:					
Deposits .....	\$ (1,000)	\$ --	\$2,107,199	\$ --	\$2,106,1
Debt .....	345,024	880	10,162	--	356,0
Accounts payable ....	259	14,536	73,993	(5,315)	83,4
Deferred income .....	12,718	49,934	178,170	(5,315)	235,5
Accrued expenses and other liabilities	427,429	(64,488)	(291,714)	--	71,2
<b>Total liabilities ...</b>	<b>784,430</b>	<b>862</b>	<b>2,077,810</b>	<b>(10,630)</b>	<b>2,852,4</b>
<b>Total stockholders' equity .....</b>	<b>883,553</b>	<b>1,588,918</b>	<b>1,442,295</b>	<b>(3,031,213)</b>	<b>883,5</b>
<b>Total liabilities and stockholders' equity .....</b>	<b>\$ 1,667,983</b>	<b>\$ 1,589,780</b>	<b>\$ 3,520,105</b>	<b>\$ (3,041,843)</b>	<b>\$3,736,0</b>

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METRIS COMPANIES INC.  
 Supplemental Consolidating Statements of Income  
 Year Ended December 31, 2001  
 (Dollars in thousands)

Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations
--------------------------	---------------------------	-------------------------------	--------------

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Net Interest Income				
(Expense) .....	\$ 8,583	\$ (7,480)	\$ 529,607	\$ --
Provision for loan losses .....	2,402	--	546,743	--
	-----	-----	-----	-----
Net Interest Income				
(Expense) After Provision				
for Loan Losses .....	6,181	(7,480)	(17,136)	--
	-----	-----	-----	-----
Other Operating Income:				
Net securitization and				
credit card servicing				
income .....	9,511	--	507,888	--
Credit card fees,				
interchange and other				
credit card income .....	(5,551)	31,508	270,969	--
Enhancement services				
revenues .....	--	57,836	282,296	--
Intercompany allocations .....	153	229,642	(229,795)	--
	-----	-----	-----	-----
	4,113	318,986	831,358	--
	-----	-----	-----	-----
Other Operating Expense:				
Credit card account and				
other product solicitation				
and marketing expenses.....	--	12,642	162,241	--
Employee compensation .....	1,101	197,645	26,717	--
Data processing services and				
communications.....	3	(90,538)	180,757	--
Warranty and debt waiver				
underwriting and claims				
servicing expense .....	--	877	34,751	--
Credit card fraud losses .....	1	5	9,062	--
Purchased portfolio				
premium amortization .....	--	--	30,277	--
Other .....	(393)	127,530	21,476	--
Intercompany allocations .....	127	57,355	(57,482)	--
	-----	-----	-----	-----
	839	305,516	407,799	--
	-----	-----	-----	-----
Income Before Income Taxes,				
Equity in Income of				
Subsidiaries and Cumulative				
Effect of Accounting Change .....	9,455	5,990	406,423	--
Income taxes .....	3,621	2,294	155,662	--
Equity in income of				
subsidiaries .....	239,958	236,262	--	(476,220)
	-----	-----	-----	-----
Income Before Cumulative				
Effect of Accounting Change .....	245,792	239,958	250,761	(476,220)
Cumulative effect of				
accounting change, net .....	--	--	14,499	--
	-----	-----	-----	-----
Net Income .....	\$ 245,792	\$ 239,958	\$ 236,262	\$ (476,220)
	=====	=====	=====	=====

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METRIS COMPANIES INC.  
 Supplemental Consolidating Statements of Income  
 Year Ended December 31, 2000  
 (Dollars in thousands)

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	-----	-----	-----	-----	-----
Net Interest (Expense) Income ...	\$ (76,200)	\$ (4,685)	\$452,657	\$ --	\$ --
Provision for loan losses .....	(4)	--	388,238	--	--
	-----	-----	-----	-----	-----
Net Interest (Expense) Income After Provision for Loan Losses .....	(76,196)	(4,685)	64,419	--	--
	-----	-----	-----	-----	-----
Other Operating Income:					
Net securitization and credit card servicing income .....	3,544	(3)	440,713	--	--
Credit card fees, interchange and other credit card income .....	504	633	222,196	--	--
Enhancement services revenues ...	--	54,747	211,453	--	--
	-----	-----	-----	-----	-----
	4,048	55,377	874,362	--	--
	-----	-----	-----	-----	-----
Other Operating Expense:					
Credit card account and other product solicitation and marketing expenses	--	21,917	122,564	--	--
Employee compensation .....	--	147,567	31,025	--	--
Data processing services and communications	--	(82,227)	168,393	--	--
Warranty and debt waiver underwriting and claims servicing expense .....	--	1,353	25,078	--	--
Credit card fraud losses .....	5	--	8,881	--	--
Purchased portfolio premium amortization .....	--	--	19,275	--	--
Other .....	(119)	57,812	72,890	--	--
	-----	-----	-----	-----	-----
	(114)	146,422	448,106	--	--
	-----	-----	-----	-----	-----
(Loss) Income Before Income Taxes, Equity in Income of Subsidiaries and Cumulative Effect of Accounting Change .....	(72,034)	(95,730)	490,675	--	--
Income taxes .....	(27,733)	(38,485)	190,538	--	--
Equity in income of subsidiaries .....	239,454	296,699	--	(536,153)	--
	-----	-----	-----	-----	-----
Income Before Cumulative Effect of Accounting Change ..	195,153	239,454	300,137	(536,153)	--
Cumulative effect of					

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accounting change, net .....	--	--	3,438	--	
Net Income .....	\$ 195,153	\$ 239,454	\$296,699	\$ (536,153)	\$

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METRIS COMPANIES INC.  
Supplemental Consolidating Statements of Income  
Year Ended December 31, 1999  
(Dollars in thousands)

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Elimina
Net Interest (Expense) Income ...	\$ (39,529)	\$ (974)	\$ 220,831	\$
Provision for loan losses .....	248	--	174,552	
Net Interest (Expense) Income After Provision for Loan Losses .....	(39,777)	(974)	46,279	
Other Operating Income:				
Net securitization and credit card servicing income .....	5,601	(4)	313,276	
Credit card fees, interchange and other credit card income .....	886	(4,088)	133,010	
Enhancement services revenues ...	--	51,341	123,750	
	6,487	47,249	570,036	
Other Operating Expense:				
Credit card account and other product solicitation and marketing expenses .....	--	36,751	70,975	
Employee compensation	--	110,886	11,531	
Data processing services and communications .....	--	(66,273)	132,243	
Warranty and debt waiver underwriting and claims servicing expense .....	--	2,755	18,336	
Credit card fraud losses .....	17	--	7,367	
Purchased portfolio premium amortization .....	--	--	31,752	
Other .....	1,071	32,997	47,576	
	1,088	117,116	319,780	
(Loss) Income Before Income Taxes, Equity in Income of Subsidiaries and Extraordinary Loss .....	(34,378)	(70,841)	296,535	
Income taxes .....	(13,647)	(28,471)	118,071	

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Equity in income of subsidiaries .....	136,094	178,464	--	(314,
Income Before Extraordinary Loss .....	115,363	136,094	178,464	(314,
Extraordinary loss from the early extinguishment of debt .....	50,808	--	--	
Net Income .....	\$ 64,555	\$ 136,094	\$ 178,464	\$ (314,

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METRIS COMPANIES INC.  
Supplemental Condensed Consolidating Statements of Cash Flows  
Year Ended December 31,  
(Dollars in thousands)

2001  
----

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolid
Operating Activities:				
Net cash provided by operating activities .....	\$ 33,007	\$ 339	\$ 763,959	\$ 797,
Investing Activities:				
Net proceeds from sales and repayments of securitized loans .....	--	--	1,854,257	1,854
Net loans originated or collected .....	1,131	--	(2,633,708)	(2,632
Credit card portfolio acquisitions .....	--	--	(290,774)	(290
(Additions to) dispositions of premises and equipment .....	--	(18,258)	12,552	(5
Net cash provided by (used in) investing activities .....	1,131	(18,258)	(1,057,673)	(1,074
Financing Activities:				
Net (decrease) increase in debt .....	(10,243)	8,623	293,458	291
Net decrease in deposits .....	--	--	(48,191)	(48
Cash dividends paid .....	(3,752)	--	--	(3
Net (decrease) increase in equity .....	(54,385)	143	71,502	17
Repurchase of common stock .....	(13,014)	--	--	(13
Net cash (used in) provided by financing activities .....	(81,394)	8,766	316,769	244
Net (decrease) increase in cash and cash equivalents .....	(47,256)	(9,153)	23,055	(33
Cash and cash equivalents at beginning of year	64,869	10,658	445,913	521



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Cash and cash equivalents at end of year	\$ 17,613	\$ 1,505	\$ 468,968	\$ 488
--	-----------	----------	------------	--------

2000

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidated
<b>Operating Activities:</b>				
Net cash (used in) provided by operating activities .....	\$ (78,840)	\$ (13,591)	\$ 748,691	\$ 656
<b>Investing Activities:</b>				
Net proceeds from sales and repayments of securitized loans .....	--	--	690,621	690
Net loans originated or collected .....	(417)	--	(2,104,061)	(2,104)
Credit card portfolio acquisitions .....	--	--	(195,597)	(195)
Additions to premises and equipment ....	--	(54,552)	(30,455)	(85)
Net cash used in investing activities ..	(417)	(54,552)	(1,639,492)	(1,694)
<b>Financing Activities:</b>				
Net increase (decrease) in debt .....	242,667	(47,376)	(184,237)	11
Net increase in deposits .....	--	--	1,330,818	1,330
Cash dividends paid .....	(2,942)	--	--	(2)
Net (decrease) increase in equity .....	(139,218)	125,868	39,628	26
Net cash provided by financing activities .....	100,507	78,492	1,186,209	1,365
Net increase in cash and cash equivalents .....	21,250	10,349	295,408	327
Cash and cash equivalents at beginning of year .....	43,619	309	150,505	194
Cash and cash equivalents at end of year	\$ 64,869	\$ 10,658	\$ 445,913	\$ 521

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METRIS COMPANIES INC.  
Supplemental Condensed Consolidating Statements of Cash Flows  
Year Ended December 31, 1999  
(Dollars in thousands)

	Metris Companies Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidated
<b>Operating Activities:</b>				
Net cash (used in) provided by operating				

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activities .....	\$ (12,089)	\$ (19,710)	\$ 344,187	\$
	-----	-----	-----	-----
Investing Activities:				
Net proceeds from sales and repayments of securitized loans .....	--	--	1,138,291	1,
Net loans originated or collected .....	(693)	--	(1,005,206)	(1,
Credit card portfolio acquisitions .....	--	--	(1,156,673)	(1,
Additions to premises and equipment ....	--	(20,944)	(20,780)	
	-----	-----	-----	-----
Net cash used in investing activities ..	(693)	(20,944)	(1,044,368)	(1,
	-----	-----	-----	-----
Financing Activities:				
Net increase (decrease) in debt .....	351,658	(97,800)	(119,742)	
Net increase in deposits .....	--	--	775,381	
Cash dividends paid .....	(1,390)	(804)	804	
Net (decrease) increase in equity .....	(288,860)	139,723	151,733	
	-----	-----	-----	-----
Net cash provided by financing activities .....	61,408	41,119	808,176	
	-----	-----	-----	-----
Net increase in cash and cash equivalents .....	48,626	465	107,995	
Cash and cash equivalents at beginning of year .....	(5,007)	(156)	42,510	
	-----	-----	-----	-----
Cash and cash equivalents at end of year.	\$ 43,619	\$ 309	\$ 150,505	\$
	=====	=====	=====	=====

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Metris Companies Inc. and Subsidiaries  
Summary of Consolidated Quarterly Financial Information and Stock  
(Dollars in thousands, except per-share data) (unaudited)

	Fourth Quarter	Third Quarter	2001 Second Quarter	First Quarter
	-----	-----	-----	-----
Summary of Operations:				
Interest Income .....	\$ 175,847	\$ 179,207	\$ 172,207	\$ 169,72
Interest Expense .....	31,984	42,148	44,313	47,83
	-----	-----	-----	-----
Net Interest Income .....	143,863	137,059	127,894	121,89
Provision for Loan Losses .....	230,221	116,513	114,682	87,72
Other Operating Income .....	365,640	283,180	277,449	228,18
Other Operating Expense .....	164,625	189,376	188,930	171,22
	-----	-----	-----	-----
Income Before Income Taxes and Cumulative Effect of Accounting Change .....	114,657	114,350	101,731	91,13
Income Taxes .....	43,915	43,614	38,963	35,08

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Income Before Cumulative Effect of Accounting Change .....	70,742	70,736	62,768	56,04
Cumulative Effect of Accounting Change (Net of Income Taxes of \$9,000) .....	--	--	--	14,49
Net Income .....	70,742	70,736	62,768	41,54
Preferred Stock Dividends .....	8,987	8,788	8,593	8,40
Net Income Applicable to Common Stockholders .....	\$ 61,755	\$ 61,948	\$ 54,175	\$ 33,14
Per Common Share: Earnings per Share:				
Basic (1) .....	\$ 0.73	\$ 0.72	\$ 0.64	\$ 0.4
Diluted (1) .....	0.72	0.70	0.63	0.4
Shares used to Compute EPS (000's):				
Basic .....	97,610	98,846	97,633	96,6
Diluted .....	98,727	101,026	99,841	98,4
Cash Dividends .....	\$ 0.010	\$ 0.010	\$ 0.010	\$ 0.0
Market Prices:				
High .....	\$ 28.10	\$ 38.65	\$ 33.71	\$ 31.
Low .....	15.10	20.00	20.13	20.
Close .....	25.71	24.75	33.71	20.

(1) Earnings per share for the first quarter reflects the \$14.5 million one-time, non-cash accounting impact from the adoption of SFAS 133.

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Metris Companies Inc. and Subsidiaries  
Summary of Consolidated Quarterly Financial Information and Stock  
(Dollars in thousands, except per-share data) (unaudited)

	2000			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	-----	-----	-----	-----
Summary of Operations:				
Interest Income .....	\$ 156,378	\$ 134,840	\$ 115,759	\$ 97,801
Interest Expense .....	44,722	35,394	28,782	24,108
Net Interest Income .....	111,656	99,446	86,977	73,693
Provision for Loan Losses .....	91,290	110,936	98,215	87,793
Other Operating Income .....	214,663	239,629	238,023	241,472
Other Operating Expense .....	156,475	149,649	148,167	140,123
	-----	-----	-----	-----

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Income Before Income Taxes and Cumulative Effect of Accounting Change .....	78,554	78,490	78,618	87,249
Income Taxes .....	29,999	30,130	30,338	33,853
	-----	-----	-----	-----
Income Before Cumulative Effect of Accounting Change .....	48,555	48,360	48,280	53,396
Cumulative Effect of Accounting Change (Net of Income Taxes of \$2,180) .....	--	--	--	3,438
	-----	-----	-----	-----
Net Income .....	48,555	48,360	48,280	49,958
Preferred Stock Dividends .....	8,220	8,036	7,770	7,598
	-----	-----	-----	-----
Net Income Applicable to Common Stockholders .....	\$ 40,335	\$ 40,324	\$ 40,510	\$ 42,360
	=====	=====	=====	=====
Per Common Share:				
Earnings per Share:				
Basic (1) .....	\$ 0.53	\$ 0.54	\$ 0.55	\$ 0.57
Diluted (1) .....	0.51	0.52	0.53	0.55
Shares used to Compute EPS (000's):				
Basic .....	91,314	90,457	88,002	87,126
Diluted .....	93,731	93,444	91,568	90,658
Cash Dividends .....	\$ 0.010	\$ 0.010	\$ 0.007	\$ 0.006
Market Prices:				
High .....	\$ 42.25	\$ 42.56	\$ 29.81	\$ 26.71
Low .....	22.81	25.13	22.00	14.83
Close .....	26.31	39.50	25.14	25.92

(1) Earnings per share for the first quarter reflects the \$3.4 million one-time, non-cash accounting impact from the adoption of SAB 101 for our debt waiver products.

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Stock Data

The Company's common stock, which is traded under the symbol "MXT," has been listed on the New York Stock Exchange since May 7, 1999. Prior to its listing on the New York Stock Exchange, the Company's common stock traded under the symbol "MTRS" on the Nasdaq Stock Market since the initial public offering on October 25, 1996. As of March 15, 2002, there were approximately 350 holders of record and approximately 16,000 beneficial holders of the Company's common stock.

MANAGEMENT'S REPORT ON CONSOLIDATED FINANCIAL STATEMENTS  
AND INTERNAL CONTROL

The accompanying consolidated financial statements, related financial data, and other information in this annual report were prepared by the management of Metris Companies Inc. Management is responsible for the integrity and objectivity of the data presented, including amounts that must necessarily be based on judgments and estimates. The consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America.

Management of Metris Companies Inc. depends on its accounting systems and internal control structures in meeting its responsibilities for reliable consolidated financial statements. In management's opinion, these systems and structures provide reasonable assurance that assets are safeguarded and that transactions are properly recorded and executed in accordance with management's authorizations. As an integral part of these systems and structures, the Company employs a professional staff of internal auditors who conduct operational and special audits and coordinate audit coverage with Company management and the independent auditors.

The consolidated financial statements have been audited by the Company's independent auditors, KPMG LLP, whose independent professional opinion appears separately. Their opinion on the consolidated financial statements is based on auditing procedures that include performing selected tests of transactions and records as they deem appropriate. These auditing procedures are designed to provide reasonable assurance that the consolidated financial statements are free of material misstatement.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets quarterly with the internal auditors, the independent auditors and management to review the work of each and ensure that each is properly discharging its responsibilities. The internal and independent auditors have free access to the Audit Committee to discuss the results of their audit work and their findings.

/s/ Ronald N. Zebeck

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Ronald N. Zebeck  
Chairman and  
Chief Executive Officer

/s/ David D. Wesselink

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David D. Wesselink  
Vice Chairman  
Principal Financial Officer

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders  
Metris Companies Inc.:

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We have audited the accompanying consolidated balance sheets of Metris Companies Inc. and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Metris Companies Inc. and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 18 to the consolidated financial statements, the Company changed its method of accounting for derivative financial instruments in 2001. As discussed in Note 2 to the consolidated financial statements, the Company changed its method of recognizing revenue for its debt waiver products in 2000.

/s/ KPMG LLP

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KPMG LLP  
Minneapolis, Minnesota  
January 16, 2002

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item with respect to directors is set forth under "Proposal One: Election of Directors," in the Company's Proxy Statement for the Annual Meeting of Shareholders held on May 7, 2002, which was filed within 120 days of December 31, 2001 and is incorporated herein by reference. The information required by this item with respect to executive

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officers is, pursuant to instruction 3 of Item 401(b) of Regulation S-K, set forth in Part I of this Form 10-K/A under "Executive Officers of the Registrant." The information required by this item with respect to reports required to be filed under Section 16(a) of the Securities Exchange Act of 1934 is set forth under "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement and is incorporated herein by reference.

### Item 11. Executive Compensation

The information required by this item is set forth under "Compensation Tables and Compensation Matters" in the Proxy Statement and is incorporated herein by reference.

### Item 12. Security Ownership of Certain Beneficial Owners and Management

The information required by this item is set forth under "Company Stock Owned by Officers and Directors" and "Persons Owning More Than Five Percent of Company's Common Stock" in the Proxy Statement and is incorporated herein by reference.

### Item 13. Certain Relationships and Related Transactions

The information required by this item is set forth under "Corporate Governance" in the Proxy Statement and is incorporated herein by reference.

With the exception of the information incorporated by reference in Items 10-13, the Proxy Statement is not to be deemed filed as part of this Form 10-K/A.

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## PART IV

### Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are made part of this Report:

1. Consolidated Financial Statements - See Item 8 above.
2. Financial Statement Schedules

All schedules to the consolidated financial statements normally required by Form 10-K are omitted since they are either not applicable or the required information is shown in the financial statements or the notes thereto.

(b) Reports on Form 8-K: None

(c) Exhibits: See Exhibit Index on page 116 of this Report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on the 22nd day of October, 2002.

METRIS COMPANIES INC.

(Registrant)

By /s/ Ronald N. Zebeck

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Ronald N. Zebeck  
Chairman and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of Metris Companies Inc., the Registrant, and in the capacities and on the dates indicated.

Signature -----	Title -----	Date -----
Principal executive officer and director:	Chairman and Chief Executive Officer	October 22, 2002

/s/ Ronald N. Zebeck

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Ronald N. Zebeck

Principal financial officer:	Vice Chairman	October 22, 2002
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/s/ David D. Wesselink

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David D. Wesselink

Principal accounting officer:	Senior Vice President, Controller	October 22, 2002
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/s/ Mark P. Wagener

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Mark P. Wagener

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Certifications

I, Ronald N. Zebeck, certify that:

1. I have reviewed this amended Annual Report on Form 10-K/A of Metris Companies Inc.;



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2. Based on my knowledge, this amended Annual Report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this amended Annual Report; and
3. Based on my knowledge, the financial statements, and other financial information included in this amended Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this amended Annual Report.

Date: October 22, 2002

/s/ Ronald N. Zebeck  
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Ronald N. Zebeck  
Chairman and Chief Executive Officer  
(Principal Executive Officer)

I, David D. Wesselink, certify that:

4. I have reviewed this amended Annual Report on Form 10-K/A of Metris Companies Inc.;
5. Based on my knowledge, this amended Annual Report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this amended Annual Report; and
6. Based on my knowledge, the financial statements, and other financial information included in this amended Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this amended Annual Report.

Date: October 22, 2002

/s/ David D. Wesselink  
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David D. Wesselink  
Vice Chairman  
(Principal Financial Officer)

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Directors:

/s/ Lee R. Anderson, Sr.                      Director                      October 22, 2002  
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Lee R. Anderson, Sr.

/s/ C. Hunter Boll                              Director                      October 22, 2002  
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C. Hunter Boll

/s/ John A. Cleary                              Director                      October 22, 2002



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- (a) First Supplemental Indenture, dated as of June 25, 1999, among MCI, the Guarantors named therein and the First National Bank of Chicago (incorporated by reference to Exhibit 4.4 to MCI's Registration Statement on Form S-4 (File No. 333-86695)).
  - (b) Second Supplemental Indenture, dated as of February 28, 2000, among MCI, the Guarantors named therein and Bank One Trust Company, N.A., as Trustee, successor in interest to the First National Bank of Chicago (incorporated by reference to Exhibit 4.2 to MCI's Quarterly Report on Form 10-Q for the period ended March 31, 2000 (File No. 1-12351)).
  - (c) Third Supplemental Indenture, dated as of January 2, 2001, among MCI, the guarantors named therein and Bank One Trust Company, N.A. (incorporated by reference to Exhibit 4.1(c) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).
  - (d) Agreement of Resignation, Appointment and Acceptance, dated as of November 14, 2001, among MCI, Bank One Trust Company, N.A., as Prior Trustee, and US Bank National Association, as Successor Trustee (incorporated by reference to Exhibit 4.1(d) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).
- 4.2 Certificate of Designation of Series B Perpetual Preferred Stock (incorporated by reference to Exhibit 4.1 of MCI's

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Current Report on Form 8-K dated December 22, 1998 (File No. 1-12351)).

- 4.3 Certificate of Designation of Series C Perpetual Preferred Stock (incorporated by reference to Exhibit 4.2 of MCI's Current Report on Form 8-K dated December 22, 1998 (File No. 1-12351)).
- (a) Amended Certificate of Designation of Series C Perpetual Convertible Preferred Stock (incorporated by reference to Exhibit 3.3 to MCI's Registration Statement on Form S-3 (File No. 333-82007)).
- 4.4 Certificate of Designation of Series D Junior Participating Convertible Preferred Stock (incorporated by reference to Exhibit 4.3 of MCI's Current Report on Form 8-K dated December 22, 1998 (File No. 1-12351)).
- 4.5 Registration Rights Agreement, dated as of December 9, 1998, between MCI and the Investors named therein (incorporated by reference to Exhibit 10.3 to MCI's Current Report on Form 8-K dated December 22, 1998 (File No. 1-12351)).
- 4.6 Form of common stock certificate of MCI (incorporated by reference to Exhibit 4.3 to MCI's Registration Statement on Form S-8 (File No. 333-91917)).
- 4.7 Indenture, dated as of July 13, 1999, by and among MCI, Metris Direct, Inc. and The Bank of New York, including Form of 10 1/8% Senior Notes due 2006 and Form of Guarantee (incorporated by reference to Exhibit 4.1 to MCI's Registration Statement on Form S-4 (File No. 333-86695)).
- (a) First Supplemental Indenture, dated as of February 28, 2000, among MCI, the Guarantors named therein and The Bank of New York, (incorporated by reference to Exhibit 4.1 to MCI's Quarterly Report on

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Form 10-Q for the period ended March 31, 2000 (File No. 1-12351)).

- (b) Second Supplemental Indenture, dated as of February 2, 2001, among MCI, the Guarantors named therein and The Bank of New York (incorporated by reference to Exhibit 4.7(b) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).
- 4.8 Exchange and Registration Rights Agreement, dated as of July 13, 1999, by and among MCI, Bear, Stearns & Co. Inc., Chase Securities Inc., Salomon Smith Barney Inc. and Barclays Capital Inc., relating to the new notes (incorporated by reference to Exhibit 4.2 to MCI's Registration Statement on Form S-4 (File No. 333-86695)).

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### Material Contracts

- 10.1 Second Amended and Restated Pooling and Servicing Agreement, dated as of January 22, 2002, among Metris Receivables, Inc. ("MRI"), as Transferor, Direct Merchants Credit Card Bank, National Association ("Direct Merchants Bank"), as Servicer, and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.3 to MRI's Current Report on Form 8-K dated January 24, 2002 (File No. 0-23961)).
- 10.2 Second Amended and Restated Bank Receivables Purchase Agreement, dated as of January 22, 2002, between Direct Merchants Bank and MCI (incorporated by reference to Exhibit 4.1 to MRI's Current Report on Form 8-K dated January 24, 2002 (File No. 0-23961)).
- 10.3 Second Amended and Restated Bank Receivables Purchase Agreement, dated as of January 22, 2002, between MCI and MRI (incorporated by reference to Exhibit 4.2 to MRI's Current Report on Form 8-K dated January 24, 2002 (File No. 0-23961)).
- 10.4\* Change of Control Severance Agreement, dated as of May 15, 1998, by and between MCI and Ronald N. Zebeck and a schedule of executive officers of the Company also having such an agreement with MCI, indicating the differences from the version of agreement filed (as permitted by Instruction 2 to Item 601 of Regulation S-K) (incorporated by reference to Exhibit 10.2 to MCI's Quarterly Report on Form 10-Q for the quarter ended September 30, 1998 (File No. 1-12351)).
  - (a) Amendment to Ronald N. Zebeck's Change of Control Severance Agreement, dated as of December 9, 1998 (incorporated by reference to Exhibit 10.7(i) to MCI's Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 1-12351)).
  - (b) Amended Schedule of Executive Officers with Change of Control Severance Agreements (incorporated by reference to Exhibit 10.4(b) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).
- 10.5\* Retention Agreement, dated May 17, 1999, between Ronald N. Zebeck and MCI (incorporated by reference to Exhibit 10.2 to MCI's Quarterly Report on Form 10-Q for the quarter ended June 30, 1999 (File No. 1-12351)).
- 10.6 Amended and Restated Credit Agreement, dated as of July 21, 2000, among MCI; the Lenders from time to time parties thereto; The Chase Manhattan

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Bank, as Administrative Agent; Bank of America, N.A., as Syndicate Agent; Deutsche Bank AG, New York Branch, as Co-Documentation Agent; U.S. Bank National Association, as Co-Documentation Agent; and Barclays Bank PLC, as Co-Agent (incorporated by reference to MCI's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000 (File No. 1-12351)).

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- (a) Amendment No. 1, dated as of July 10, 2001, to the Amended and Restated Credit Agreement, among MCI; the Lenders from time to time parties thereto; The Chase Manhattan Bank, as Administrative Agent; Bank of America, N.A., as Syndication Agent; Deutsche Bank AG, New York Branch, as Co-Documentation Agent; U.S. Bank National Association, as Co-Documentation Agent; and Barclays Bank PLC, as Co-Agent (incorporated by reference to Exhibit 10.6(a) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).
- 10.7\* MCI Non-Employee Director Stock Option Plan (incorporated by reference to Exhibit 10.3 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).
- 10.8\* MCI Management Stock Purchase Plan (incorporated by reference to Exhibit 10.4 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).
- 10.9\* MCI Amended and Restated Annual Incentive Bonus Plan for Designated Corporate Officers (incorporated by reference to Exhibit 10.5 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).
- 10.10\* MCI Amended and Restated Long-Term Incentive and Stock Option Plan (incorporated by reference to Exhibit 10.6 to MCI's Registration Statement on Form S-4/A (File No. 333-86695)).
- (a) Form of Non-Qualified Stock Option Agreement (incorporated by reference to Exhibit 10.8 to MCI's Annual Report on Form 10-K for the year ended December 31, 1998 (File No. 1-12351)).
- (b) Form of Non-Qualified Performance Accelerated Stock Option Agreement (incorporated by reference to Exhibit 10.10(b) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).
- (c) Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.10(c) to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).
- 10.11 Transfer and Administration Agreement, dated June 15, 2001, among Direct Merchants Bank, as transferor, Variable Funding Capital Corporation, as a conduit investor, First Union National Bank, as a committed investor and as liquidity agent, and First Union Securities Inc., as deal agent (incorporated by reference to Exhibit 10.11 to MCI's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-12351)).

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### Other Exhibits

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- 11 Computation of Earnings Per Share.

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- 12 (a) Computation of Ratio of Earnings to Fixed Charges.
  - 12 (b) Computation of Ratio of Earnings to Fixed Charges and Preferred Dividends.
  - 21 Subsidiaries of MCI.
  - 23 Independent Auditors' Consent.
  - 99.1 Certification of Principal Executive Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.
  - 99.2 Certification of Principal Financial Officer Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code.
- \* Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.