

Prospectus

Credit Cards, 2005: The Outlook Dims

- **The Impact Of New Minimum Payment Rules**
 - **Bankruptcy Reform: Filings Forecast To 2008**
 - **Home Equity-Sourced Card Balance Payoffs:
New Ideas For How To Cope**
 - **2004 Rankings By Lender: Receivables,
Growth, Net Chargeoffs, & Credit Lines**
 - **Detailed Industry Size & Growth Statistics**
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Important Information about a new SMR Research Study

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SUMMARY OF THE STUDY

Tougher times are ahead for U.S. credit card issuers. Five separate and major events are hitting home at once:

- **Combined home equity and cashout refi originations are growing.** This cash, often used to pay off card balances, is cutting card interest income.

U.S. general purpose card receivables, measured in this study, showed meager growth for the second straight year in 2004. Things look bad for 2005, too. The gap between charge volume and receivables growth rates has never been so large.

- **Personal bankruptcies are spiking, as consumers rush to file before the new law kicks in this October.**

- **Bankruptcies will fall dramatically after October, but then, the reduction in these losses may be offset fully by new federally mandated increases in minimum monthly payments.**

- **The cost of funds is rising, and the yield curve is flat.** Card interest expense will increase. The flat yield curve will make cheap cashout refis and closed-end home equity loans even more alluring to pay off card balances.

- **Retailers are organizing again, probably for another antitrust suit to fight rising merchant card fees.** This time, we think, they'll aim for the right to offer their customers discounts for paying with cash or checks.

All things considered, this is more trouble than card issuers have ever faced before at one time. Is there any hope? Yes, there is.

This study is our 20th annual detailed report on the U.S. credit card industry. **Special sections** investigate the probable impact of the new bankruptcy law, the new minimum payment rules, and what to do about rising card balance attrition from the proceeds of consumer home loans.

The study also includes new and expanded coverage of U.S. card industry size, growth, and characteristics. This study is the only one that combines data from the four major brands to look at detailed trends over time.

We rank the issuers by receivables, growth rates, net chargeoff rates, total credit lines extended, line draw-down rates, and other stats. We include this year a bankruptcy filing quarterly forecast through year 2008, and other new features as well.

This Prospectus shows the full contents of the study. An Order Form is enclosed. Thanks.

HIGHLIGHTS

Higher Minimum Payments: 3 Impacts

In its 2004 annual report, MBNA warned that new federally mandated increases in credit card minimum payments would reduce its future receivables. Citigroup said the same requirements probably would “increase delinquencies and credit loss.”

Unfortunately, both companies are right. And there’s more, too. Late and over-limit fees, a major industry income stream, will no longer be so lucrative. Every time you charge one, you will now push strained cardholders closer to default, because their required monthly payment will balloon.

MBNA will implement its new formula in the Fall. **Under it, a problem debtor owing \$10,000 at 29% with one late fee sees his minimum payment rise by \$149.35.**

The same debtor owing only \$1,000 sees his minimum payment triple. His receivable balance also declines by 4.74% from what it would have been before.

Some issuers are trying to implement less aggressive new rules, but we suspect that federal regulators won’t accept them all. Our study walks through eight detailed minimum payment change scenarios and analyzes the impacts.

Bankruptcy Reform: Done Deal

Luckily, just as rising minimum payments cut into card income, the new Bankruptcy Abuse Prevention Act will help out. Whether the savings will make up for the minimum payment losses remains to be seen.

SMR was a primary supplier of research to the lender coalition that fought for this bill since 1997. We present more than 20 pages of analysis and projections on what bankruptcies will be like once the new law takes effect. **We are certain that this law is going to reduce filings and their costs very significantly in 2006 and beyond.**

Until then, things get worse – much worse – as consumer lawyers push all the clients they can into court prior to the October, 2005, effective date for most of the new law’s provisions.

The study includes our projections for the degree to which bankruptcies will spike in the “lame duck” period – and also for numbers of filings quarterly through 2008.

HIGHLIGHTS

The Receivables Dilemma: How To Cope

U.S. credit card charge volume rose neatly in 2004. But it was another terrible year for card outstandings. The gap between the two annual growth rates – charge volume versus receivables – is the largest yet.

Charge volume and receivables used to grow by near-identical rates. As a 15-year chart in our study shows, the two growth rates began to diverge in 1998. Today, the gap between them is a gulf.

A separate section of this study investigates sluggish receivables growth – and what might be done to change it.

As we reported a year ago, most of the receivables problem stems from consumers using home equity loans and cashout refinances to pay off card balances. **We show that the sum total of cash produced through these loans reached a new record high in 2004. It's likely to climb again in 2005.**

How do you compete against an adjustable-rate cashout refi, supplying cash at 4.2% interest that's tax deductible? **Maybe you don't.**

The study tells how new predictive models could enable credit card issuers themselves to cross-sell home equity loans effectively to cardholders bent on getting them anyway. The same models, used in card account acquisition, could target revolvers highly unlikely to attrite.

Changes In Lender Ranks

Citigroup has retained its lead in U.S. cards over the newly combined JP Morgan and Bank One. Or at least, it has unless you believe Morgan's annual report, which claims the top position in general purpose cards.

One thing's for sure: In the U.S., JP Morgan is showing the faster internal growth rate. So, change is either taking place or may be in the offing.

But neither firm grew receivables in 2004 as fast as Wells Fargo or some other major players. Wells is using an effective cross-sell strategy to its other bank customers, described in Section III.

Lots of companies have changed their competitive positions. **Conservative USAA Savings Bank (with a net chargeoff rate of 1.35%!) increased receivables by 25.9% in 2004 to become the 12th largest U.S. issuer.**

We rank all issuers with \$100 million or more of card receivables in Section III. In Section VII, we add more company-specific data on earnings, net chargeoff rates, the year-over-year change in chargeoffs, total extended card credit lines, and draw-down rates.

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Copy Program & The Study Price

The free copies are a \$1,000 value, but we need to compensate elsewhere. Here comes the bad news.

SMR's credit card industry studies have sold for about the same price for 20 years. But the number of sizeable card issuers has declined. Also, our base price has fallen far below what's normal in the market research industry.

Check out a web site called MarketResearch.com. You'll find a study published by Packaged Facts on rewards cards – one of many subjects we cover. Price: \$3,500.

We have adjusted our base price closer to what's normal. As you will see on the Order Form, **Credit Cards, 2005**, costs \$2,950.

We designed the free-copy program to give value back for the study's base-price increase. The base price increase was necessary. Our only choice was to do it – or to end the card industry's most comprehensive research program.

Intranet Program Unchanged

These changes do not affect our Intranet program. In this program, we supply the original study in printed form, but also supply it as a Microsoft Word file, which clients may put on their internal Intranet sites.

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Thanks very much for your understanding and support.

Stu Feldstein, President