

ENCORE CAPITAL GROUP INC
Form 10-K
February 27, 2019
Table of Contents

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

FORM 10-K
(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018 or
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
COMMISSION FILE NUMBER: 000-26489
ENCORE CAPITAL GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware 48-1090909
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)

3111 Camino Del Rio North, Suite 103 San Diego, California 92108
(Address of principal executive offices) (Zip code)
(877) 445-4581

(Registrant's telephone number, including area code)

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.01 Par Value Per Share	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes 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 or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$943.6 million at June 29, 2018, based on the closing price of the common stock of \$36.60 per share on such date, as reported by NASDAQ.

The number of shares of our Common Stock outstanding at February 20, 2019, was 30,884,393.

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement in connection with its annual meeting of stockholders to be held in 2019 are incorporated by reference in Items 10, 11, 12, 13, and 14 of Part III of this Annual Report on Form 10-K for the fiscal year ended December 31, 2018, which proxy statement will be filed no later than 120 days after the close of the registrant's fiscal year December 31, 2018.

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I</u>	<u>1</u>
<u>Item 1—Business</u>	<u>1</u>
<u>Item 1A—Risk Factors</u>	<u>11</u>
<u>Item 1B—Unresolved Staff Comments</u>	<u>23</u>
<u>Item 2—Properties</u>	<u>23</u>
<u>Item 3—Legal Proceedings</u>	<u>23</u>
<u>Item 4—Mine Safety Disclosures</u>	<u>23</u>
 <u>PART II</u>	 <u>24</u>
<u>Item 5—Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>24</u>
<u>Item 6—Selected Financial Data</u>	<u>26</u>
<u>Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>29</u>
<u>Item 7A—Quantitative and Qualitative Disclosures about Market Risk</u>	<u>62</u>
<u>Item 8—Financial Statements and Supplementary Data</u>	<u>63</u>
<u>Item 9—Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	<u>63</u>
<u>Item 9A—Controls and Procedures</u>	<u>63</u>
<u>Item 9B—Other Information</u>	<u>66</u>
 <u>PART III</u>	 <u>67</u>
<u>Item 10—Directors, Executive Officers and Corporate Governance</u>	<u>67</u>
<u>Item 11—Executive Compensation</u>	<u>67</u>
<u>Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>67</u>
<u>Item 13—Certain Relationships and Related Transactions, and Director Independence</u>	<u>67</u>
<u>Item 14—Principal Accountant Fees and Services</u>	<u>67</u>
 <u>PART IV</u>	 <u>68</u>
<u>Item 15—Exhibits and Financial Statement Schedules</u>	<u>68</u>
<u>Item 16—Form 10-K Summary</u>	<u>77</u>
<u>SIGNATURES</u>	<u>78</u>

Table of Contents

PART I

Item 1—Business

Our Business

We are an international specialty finance company providing debt recovery solutions and other related services for consumers across a broad range of financial assets. We primarily purchase portfolios of defaulted consumer receivables at deep discounts to face value and manage them by working with individuals as they repay their obligations and work toward financial recovery. Defaulted receivables are consumers' unpaid financial commitments to credit originators, including banks, credit unions, consumer finance companies and commercial retailers. Defaulted receivables may also include receivables subject to bankruptcy proceedings. We also provide debt servicing and other portfolio management services to credit originators for non-performing loans.

Through Midland Credit Management, Inc. and its domestic affiliates (collectively, "MCM") we are a market leader in portfolio purchasing and recovery in the United States. Through Cabot Credit Management Limited ("CCM") and its subsidiaries and European affiliates (collectively, "Cabot") we are one of the largest credit management services providers in Europe and a market leader in the United Kingdom and Ireland. These are our primary operations. We also have additional international investments and operations as we have explored new asset classes and geographies including: (1) our investments in non-performing loans in Colombia, Peru, Mexico and Brazil; (2) our subsidiary, Baycorp Holdings Pty Limited (together with its subsidiaries, "Baycorp"), which is one of Australasia's leading debt resolution specialists, and (3) an investment in Encore Asset Reconstruction Company ("EARC") in India. We refer to these additional international operations as our Latin America and Asia-Pacific ("LAAP") operations. To date, operating results from LAAP operations have not been significant to our total consolidated operating results. As a result, descriptions of our operations in Part I - Item 1 of this Form 10-K will focus primarily on MCM (United States) and Cabot (Europe) operations.

Throughout this Annual Report on Form 10-K, when we refer to our United States operations, we include accounts originated in the United States that are serviced through our operations centers in the United States, India and Costa Rica. When we refer to our international operations, we are referring to accounts originated outside of the United States. Those accounts are generally serviced in the country of origin.

Company Information

We were incorporated in Delaware in 1999. In June 2013, we completed our merger with Asset Acceptance Capital Corp., which was another leading provider of debt recovery solutions in the United States. In July 2013, by acquiring a majority ownership interest in the indirect holding company of CCM, Janus Holdings S.a r.l., we acquired control of CCM. In February 2014, CCM acquired Marlin Financial Group Limited, a leading acquirer of non-performing consumer debt in the United Kingdom. In August 2014, we acquired Atlantic Credit & Finance, Inc., which was a market leader in the United States in buying and collecting on freshly charged-off debt. In June 2015, CCM expanded in the United Kingdom by acquiring Hillesden Securities Ltd and its subsidiaries ("dlc"). In March 2016, we completed the divestiture of our membership interests in Propel Acquisition LLC and its subsidiaries (collectively, "Propel"), our tax lien business. In November 2017, CCM strengthened its debt servicing offerings with the acquisition of Wescot Credit Services Limited, a leading U.K. contingency debt collection and BPO services company. In July 2018, we completed the purchase of all of the outstanding equity of CCM not owned by us. As a result, CCM became our wholly owned subsidiary.

Our headquarters is located in San Diego, California 92108 and our telephone number is (877) 445-4581. Our website address is www.encorecapital.com. The site provides access, free of charge, to relevant investor related information, such as our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports that are filed with or furnished to the Securities and Exchange Commission ("SEC") pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, press releases, featured articles, an event calendar, and frequently asked questions. SEC filings are available on our Internet site as soon as reasonably practicable after being filed with, or furnished to, the SEC. Also available on our website are our Standards of Business Conduct and charters for the committees of our Board of Directors. We intend to disclose any amendment to, or waiver of, a provision of our Standards of Business Conduct on our website. The content of our Internet site is not incorporated by reference into this Annual Report on Form 10-K. The SEC maintains an Internet site that contains

reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC (<http://www.sec.gov>).

Table of Contents

Our Competitive Advantages

Analytic Strength. We believe that success in our business depends on our ability to establish and maintain an information advantage. Leveraging an industry-leading financially distressed consumer database, our in-house team of statisticians, business analysts, and software programmers have developed, and continually enhance, proprietary behavioral and valuation models, custom software applications, and other business tools that guide our portfolio purchases. Moreover, our collection channels are informed by powerful statistical models specific to each collection activity, and each year we deploy significant capital to purchase credit bureau and customized consumer data that describe demographic, account level, and macroeconomic factors related to credit, savings, and payment behavior.

Consumer Intelligence. At the core of our analytic approach is a focus on characterizing our consumers' willingness and ability to repay their financial obligations. In this effort, we apply tools and methods from statistics, psychology, economics, and management science across the full extent of our business. During portfolio valuation, we use an internally developed and proprietary family of statistical models that determines the likelihood and expected amount of payment for each consumer within a portfolio. Subsequently, the expectations for each account are aggregated to arrive at a portfolio-level liquidation solution and a valuation for the entire portfolio is determined. During the collection process, we apply a number of proprietary operational frameworks to match our collection approach to an individual consumer's payment behavior.

Strong Capital Stewardship. We continue to maintain a focus on raising and deploying capital prudently to maximize the return on our invested capital. Our operational scale and geographic diversification enable us to adjust to market trends and deploy capital to maximize risk-adjusted returns.

Operational Scale and Cost Efficiency. We are a market leader in portfolio purchasing and recovery in the United States and one of the largest credit management services providers in Europe. This operational scale combined with cost efficiency is central to our collection and purchasing strategies. We experience considerable cost advantages, stemming from our operations in India and Costa Rica and the development and implementation of operational models that enhance profitability. We believe that we are the only company in our industry with a successful, late-stage collection platform in India. This cost-saving, first-mover advantage helps to reduce our call center variable cost-to-collect.

Principled Intent. Across the full extent of our operations, we strive to treat consumers with respect, compassion, and integrity. From affordable payment plans to hardship solutions, we work with our consumers as they attempt to return to financial health. We are committed to dialogue that is honorable and constructive and hope to play an important and positive role in our consumers' financial recovery. We believe that our interests, and those of the financial institutions from which we purchase portfolios, are closely aligned with the interests of government agencies seeking to protect consumer rights. We expect to continue investing in infrastructure and processes that support consumer advocacy and financial literacy while promoting an appropriate balance between corporate and consumer responsibility.

Our Strategy

Continue to Invest in our Core Businesses in the United States. Our core domestic portfolio purchasing and recovery business remains critical to our success. Supply and demand dynamics within the United States have fluctuated over time and will likely continue to do so. To position ourselves to continue generating strong risk-adjusted returns, we intend to continue investing in analytics, technology, risk management and compliance. We will also continue investing in initiatives that enhance our relationships with consumers, expand our digital capabilities and collections, or improve liquidation rates on our portfolios. We also plan to invest in software and systems designed to better integrate our operations and improve our overall efficiency. We intend to continue deploying a meaningful amount of capital in our core domestic markets.

Strengthen and Develop our U.K. and European Businesses. We believe we are well-positioned through Cabot to maintain and strengthen our leading role in the distressed consumer debt sectors in the U.K. and in certain markets within Europe. We intend to preserve our market leading position in the U.K. by maintaining a high level of collections performance and compliance. We also intend to continue investing in developing our digital capabilities as well as our leading data, scorecard and litigation capabilities. We will continue to explore opportunities in new geographies and asset classes.

Purchasing Approach

We provide sellers of delinquent receivables liquidity and immediate value through the purchase of charged-off consumer receivables. We believe that we are a valuable partner to these sellers given our financial strength, focus on principled intent, and track record of financial success.

Identify purchase opportunities. We maintain relationships with various financial service providers such as banks, credit unions, consumer finance companies, retailers, utilities companies and government agencies. These relationships frequently generate recurring purchase opportunities. We identify purchase opportunities and secure, where possible, exclusive negotiation

Table of Contents

rights. We believe that we are a valued partner for credit originators from whom we purchase portfolios, and our ability to secure exclusive negotiation rights is typically a result of our strong relationships and our purchasing scale. Receivable portfolios are typically sold either through a general auction, in which the seller requests bids from market participants, or in a private sale where the buyer negotiates directly with a seller. The sale transaction can be either for a one-time spot purchase or for a “forward flow” contract. A “forward flow” contract is a commitment to purchase receivables over a duration that is typically three to twelve months, but can be longer, with specifically defined volume, frequency, and pricing. Typically, these forward flow contracts have provisions that allow for early termination or price re-negotiation should the underlying quality of the portfolio deteriorate over time or if any particular month’s delivery is materially different than the original portfolio used to price the forward flow contract. In the U.S., where we have the ability in many of our forward flow contracts to terminate upon a certain specified amount of notice, we generally attempt to secure forward flow contracts for receivables because a consistent volume of receivables over a set duration can enable us to more accurately forecast and plan our operational needs.

Evaluate purchase opportunities using analytical models. Once a portfolio of interest is identified, we obtain detailed information regarding the portfolio’s accounts, including certain information regarding the consumers themselves. We use this account-level information to perform due diligence and evaluate the portfolio. We use statistical analysis and forecasting to analyze this information to create expected future cash forecasts for the portfolio. Our collection expectations are based on, among other things, demographic data, account characteristics, and credit file variables, which we use to predict a consumer’s willingness and ability to repay their debt. Our servicing strategy and collections channel capacity are also a major determinant of collections expectations and portfolio expected value. Additional adjustments to cash expectations are made to account for qualitative factors that may affect the payment behavior of our consumers (such as prior collection activities or the underwriting approach of the seller), and to ensure our valuations are aligned with our operations.

Formal approval process. Once we have determined the estimated value of the portfolio and have completed our qualitative due diligence, we present the purchase opportunity to our investment committee, which either sets the maximum purchase price for the portfolio based on an Internal Rate of Return (“IRR”) and at times also on other strategic objectives, or declines to bid. Members of the investment committee vary based on the type and amount of the purchase opportunity, but typically include our Chief Executive Officer, Chief Financial Officer, other members of our senior management team, and experts, as needed.

We believe long-term success is best achieved by combining a diversified asset sourcing approach with an account-level scoring methodology and a disciplined evaluation process.

Collection Approach

MCM (United States)

We continue to expand and build upon the insight developed from previous collections when developing our account collection strategies for portfolios we have acquired. We refine our collection approach to determine the most effective collection strategy to pursue for each account. Our current collection approaches consist of:

• **Direct Mail and Email.** We develop innovative mail and email campaigns offering consumers payment programs, and occasionally appropriate discounts, to encourage settlement of their accounts.

• **Call Centers.** We maintain domestic collection call centers in Phoenix, Arizona, St. Cloud, Minnesota, Troy, Michigan, and Roanoke, Virginia and international call centers in Gurgaon, India and San Jose, Costa Rica. Call centers generally consist of multiple collection departments. Account managers supervised by group managers are trained and divided into specialty teams. Account managers assess our consumers’ willingness and capacity to pay. They attempt to work with consumers to evaluate sources and means of repayment to achieve a full or negotiated lump sum settlement or develop payment programs customized to the individual’s ability to pay. In cases where a payment plan is developed, account managers encourage consumers to pay through automatic payment arrangements. We continuously educate account managers to understand and apply applicable laws and policies that are relevant in the account manager’s daily collection activities. Our ongoing training and monitoring efforts help ensure compliance with applicable laws and policies by account managers.

Table of Contents

Legal Action. We generally refer accounts for legal action where the consumer has not responded to our direct mail efforts or our calls and it appears the consumer is able, but unwilling, to pay their obligations. When we decide to pursue legal action, we place the account into our internal legal channel or refer them to our network of retained law firms. If placed to our internal legal channel, attorneys in that channel will evaluate the accounts and make the final determination whether to pursue legal action. If referred to our network of retained law firms, we rely on our law firms' expertise with respect to applicable debt collection laws to evaluate the accounts placed in that channel in order to make the decision about whether or not to pursue collection litigation. Prior to engaging an external law firm (and throughout our engagement of any external law firm), we monitor and evaluate the firm's compliance with consumer credit laws and regulations, operations, financial condition, and experience, among other key criteria. The law firms we hire may also attempt to communicate with the consumers in an attempt to collect their debts prior to initiating litigation. We pay these law firms a contingent fee based on amounts they collect on our behalf.

Third-Party Collection Agencies. We selectively employ a strategy that uses collection agencies. Collection agencies receive a contingent fee for each dollar collected. Generally, we use these agencies on accounts when we believe they can liquidate better or less expensively than we can or to supplement capacity in our internal call centers. We also use agencies to initially provide us a way to scale quickly when large purchases are made and as a challenge to our internal call center collection teams. Prior to engaging a collection agency, we evaluate, among other things, those aspects of the agency's business that we believe are relevant to its performance and compliance with consumer credit laws and regulations.

Digital Collections. We offer an online payment portal that enhances consumer convenience by providing consumers the ability to view account details, make payments and submit inquiries online.

Inactive. We strive to use our financial resources judiciously and efficiently by not deploying resources on accounts where the prospects of collection are remote based on a consumer's situation.

No Resale. Our policy is to not resell accounts to third parties in the ordinary course of business.

We expand and build upon the insight developed during our purchase process when developing our account collection strategies for portfolios we have acquired. Our proprietary consumer-level collectability analysis is the primary determinant of whether an account is actively serviced post-purchase. The channel identification process is analogous to a decision tree where we first differentiate those consumers who we believe are unable to pay from those who we believe are able to pay. Consumers who we believe are financially incapable of making any payments, or are facing extenuating circumstances or hardships that would prevent them from making payments, are excluded from our collection process. It is our practice to attempt to contact consumers and assess each consumer's willingness to pay through analytics, phone calls and/or letters. If the consumer's contact information is unavailable or out of date, the account is routed to our skip tracing process, which includes the use of different skip tracing companies to provide accurate phone numbers and addresses. The consumers that engage with us are presented with payment plans that are intended to suit their needs or are sometimes offered discounts on their obligations. For the consumers that do not respond to our calls or our letters we must then decide whether to pursue collections through legal action. Throughout our ownership period of accounts, we periodically refine our collection approach to determine the most effective collection strategy to pursue for each account.

Cabot (Europe)

In Europe, we also use direct mail and email, call centers, legal action, third-party collection agencies and digital methods to pursue collections.

We use insights developed during our purchasing process to build account collection strategies. Our proprietary consumer-level collectability analysis is the primary determinant of how an account will be serviced post-purchase. We continuously refine this analysis to determine the most effective collection strategy to pursue for each account we own. We purchase both paying portfolios, which consist of accounts where over 50% of the investment value is associated with consumers who are already repaying some of their debt, albeit at levels that still require the debt to be written off under the originators' internal accounting policies, and non-paying portfolios, where 50% or more of the investment value is associated with customers who are not repaying some of their debt, which are higher risk and have less predictable cash flows than paying portfolios. Paying portfolios tend to have a higher purchase price relative to face value than non-paying accounts due to the higher expectations for collections, as well as lower anticipated

collection costs. Non paying portfolios often consist of a substantial number of accounts without contact details and for which the vendor has made numerous unsuccessful attempts to collect.

4

Table of Contents

We employ a variety of collections strategies from the point of purchase, tailored to both the type of account and the consumer's financial strength. For paying accounts, we seek to engage with the consumers to transfer across their payment stream to us and understand their detailed financial situation. For non-paying accounts, we apply a segmentation framework tailoring our communication and contact intensity in line with our assessment of their credit bureau data, the size of their debt, and whether we have an existing relationship with them from other accounts. Where contact is made and consumers indicate both a willingness and ability to pay, we create tailor-made payment plans to suit the consumer's situation. In doing so, we utilize U.K. regulatory protocols to assess affordability and ensure their plan is fair, balanced and sustainable. Where we identify consumers with an ability to pay but who appear to be unwilling to pay their debt due, we pursue a range of collections strategies, which may include litigation processes in order to stimulate engagement and enable us to agree to a suitable plan. Scoring is applied in conjunction with manual selection criteria to determine whether litigation might be an option, also informing any enforcement action that may be deemed most appropriate to the consumer's situation. Relationships with consumers are maintained through the duration of the payment plan, seeking to review plans at least annually in order to take into account fluctuations in consumers' financial situations. Again, scoring is used to vary the intensity of contact effort, mirroring the likelihood of a consumer's financial situation having changed. In the event that a consumer breaks their plan, segmentation is used to tailor the communication and contact intensity as we seek to re-engage with the consumer and understand the reason for the break. By understanding the reason for the break we can tailor the solutions we recommend to rehabilitate the plan and put the customer back on the path to financial recovery. In this way, we have built strong relationships with our consumer base with a robust repayment stream, reflected in exceptional customer service scores.

Debt Servicing

Our debt servicing operations, which are primarily performed by subsidiaries of Cabot and Baycorp, include early stage collections, business process outsourcing and contingent collections for credit originators. We mainly provide debt servicing for consumer accounts, but also provide services for business-to-business accounts. We believe our debt servicing operations provide us: exposure to the oversight requirements of financial services clients that drive a continually evolving compliance agenda; access to proprietary debt purchase opportunities; and an opportunity to support clients across the collections and recoveries lifecycle, thereby allowing us to remain close to evolving trends.

Seasonality

MCM (United States)

While seasonality does not have a material impact on our business, collections are generally strongest in our first calendar quarter, slower in the second and third calendar quarters, and slowest in the fourth calendar quarter. Relatively higher collections in the first quarter could result in a lower cost-to-collect ratio compared to the other quarters, as our fixed costs are relatively constant and applied against a larger collection base. The seasonal impact on our business may also be influenced by our purchasing levels, the types of portfolios we purchase, and our operating strategies.

Collection seasonality can also affect revenue as a percentage of collections, also referred to as our revenue recognition rate. Generally, revenue for each pool group declines steadily over time, whereas collections can fluctuate from quarter to quarter based on seasonality, as described above. In quarters with lower collections (e.g., the fourth calendar quarter), the revenue recognition rate can be higher than in quarters with higher collections (e.g., the first calendar quarter).

In addition, seasonality could have an impact on the relative level of quarterly earnings. In quarters with stronger collections, total costs are higher as a result of the additional efforts required to generate those collections. Since revenue for each pool group declines steadily over time, in quarters with higher collections and higher costs (e.g., the first calendar quarter), all else being equal, earnings could be lower than in quarters with lower collections and lower costs (e.g., the fourth calendar quarter). Additionally, in quarters where a greater percentage of collections come from our legal and agency outsourcing channels, cost to collect will be higher than if there were more collections from our internal collection sites.

Cabot (Europe)

While seasonality does not have a material impact on European operations, collections are generally strongest in the second and third calendar quarters and slower in the first and fourth quarters, largely driven by the impact of the December holiday season and the New Year holiday, and the related impact on customers' ability to repay their balances. This drives a higher level of payment plan defaults over this period, which are typically repaired across the first quarter of the following year. The August vacation season in the United Kingdom also has an unfavorable effect on the level of collections, but this is traditionally compensated for by higher collections in July and September.

Table of Contents

Compliance and Enterprise Risk Management

We have established a compliance management system framework, operational procedures, and governance structures to enable us to conduct business in accordance with applicable rules, regulations, and guidelines. Our philosophy rests on well-established risk management principles including a model leveraging three lines of defense. Our first line of defense consists of business lines or other operating units, whose role is to own and manage risks and associated mitigating controls. Our second line of defense is comprised of strong legal, compliance, and enterprise risk management functions, who ensure that the business maintains policies and procedures in compliance with existing laws and regulations, advise the business on assessing risk and strengthening controls, and provide additional, related support. These second-line functions facilitate oversight by our management and Board of Directors and are responsible for promoting compliance with applicable laws and regulations, assisting in formulating and maintaining policies and procedures, and engaging in training, risk assessments, testing, monitoring, complaint response, compliance audits and corrective actions. Our third line of defense is provided by our internal audit function, providing independent assurance that both first and second line functions are performing their roles appropriately within the context of our framework.

Beyond written policies, one of our core internal goals is the adherence to principled intent as it pertains to all consumer interactions. We believe that it is in our shareholders' and our employees' best interest to treat all consumers with the highest standards of integrity. Specifically, we have strict policies and a code of ethics that guide all dealings with our consumers. Our employees undergo comprehensive training on legal and regulatory compliance, and we engage in regular call monitoring checks, data checks, performance reviews, and other operational reviews to ensure compliance with company guidelines.

Credit originators who sell us defaulted consumer receivables routinely conduct examinations of our collection practices and procedures and typically make reports with recommendations to us as to how they believe we can improve those practices and procedures. We respond to these reports in the ordinary course of business and make changes to our practices and procedures that we believe are appropriate to address any issues raised in such reports.

Information Technology

Technical Infrastructure. Our internal network has been configured to be redundant in all critical functions, at all sites. This redundancy has been implemented within the local area network switches and the data center network and includes fully redundant Multiprotocol Label Switching (MPLS) networks. We have the capability to handle high transaction volume in our server network architecture with scalability to meet and exceed our future growth plans. Redundancy, coupled with seamless scalability and our high-performance infrastructure, will allow for rapid business transformation and growth.

Omni-Channel Enabled Dialer Technology. Our call centers employ the use of upgraded dialer technology that expands our ability to service the consumer in their preferred channel of communication. This technology allows additional call volume capacity and greater efficiency through shorter wait times and an increase in the number of live contacts. This technology helps maximize account manager productivity and further optimizes the yield on our portfolio purchases. Additionally, the use of predictive dialing technology helps us comply with applicable federal and state laws in the United States that restrict the time, place, and manner in which debt collectors can call consumers. Recognizing mobile phone dialing has a different set of legal restrictions, we utilize a distinctly different platform for non-consented mobile phones in order to comply with all laws while providing a framework for us to maximize contact with our consumers.

Computer Hardware. We have made significant improvements in our data centers, and now have redundancy in support of continued growth. We use a robust computer platform to perform our daily operations, including the collection efforts of our global workforce. Our custom software applications are integrated within our database server environment allowing us to process transaction loads with speed and efficiency. The computer platform offers us reliability and expansion opportunities. Furthermore, this hardware incorporates state of the art data security protection. We back up our data utilizing a tapeless configuration, and copies are replicated to a secure secondary data center. We also mirror our production data to a remote location to give us full protection in the event of the loss of our primary data center. To ensure the integrity and reliability of our computer platform, we periodically engage outside auditors specializing in information technology and cybersecurity to examine both our operating systems and disaster

recovery plans.

Process Control. To provide assurance that our entire infrastructure continues to operate efficiently and securely, we have developed a strong process and control environment. These governance, risk management, and control protocols govern all areas of the enterprise: from physical security and cybersecurity, to change management, data protection, and segregation of duties.

Cybersecurity. We divide our cybersecurity and information security functions into the four core tenets that we believe make up a solid information security practice: (1) security strategy and architecture; (2) operational security; (3) vulnerability and threat management; and (4) IT governance, risk and controls. We invest in cybersecurity and advanced technologies, including next generation threat prevention and threat intelligence solutions, to protect our organization and consumer and

6

Table of Contents

proprietary data throughout its life cycle. We believe that our adoption and implementation of leading security frameworks for the financial services industry and the regulatory environments and geographies in which we operate demonstrates our commitment to cybersecurity and information security. To ensure the integrity and reliability of our environment, we periodically engage outside auditors specializing in cybersecurity to examine and test our technical posture as well as our detection and response capabilities.

Competition

The consumer credit recovery industry is highly competitive in the United States, the United Kingdom and throughout Europe. We compete with a wide range of collection and financial services companies, traditional contingency collection agencies and in-house recovery departments. Competitive pressures affect the availability and pricing of receivable portfolios, as well as the availability and cost of qualified recovery personnel.

When purchasing receivables, we compete primarily on the basis of price, the ease of negotiating and closing the prospective portfolio purchases with us, our ability to obtain funding, and our reputation with respect to the quality of services that we provide. We believe that our ability to compete effectively in this market is also dependent upon, among other things, our relationships with credit originators and portfolio resellers of charged-off consumer receivables, and our ability to provide quality collection strategies in compliance with applicable laws.

We believe that smaller competitors in the United States and the United Kingdom are facing difficulties in the portfolio purchasing market because of the higher cost to operate due to increased regulatory pressure and scrutiny applied by regulators. In addition, sellers of charged-off consumer receivables are increasingly sensitive to the reputational risks involved in the industry and are therefore being more selective with buyers in the marketplace. We believe this favors larger participants in this market, such as us, that are better able to adapt to these pressures.

Government Regulation

MCM (United States)

Our operations in the United States are subject to federal, state, and municipal statutes, rules, regulations, and ordinances that establish specific guidelines and procedures that debt purchasers and collectors must follow when collecting consumer accounts. It is our policy to comply with the provisions of all applicable laws in all of our recovery activities. Our failure to comply with these laws could have a material adverse effect on us to the extent that they limit our recovery activities or subject us to fines or penalties in connection with such activities.

The federal Fair Debt Collection Practices Act (“FDCPA”) and comparable state and local laws establish specific guidelines and procedures that debt collectors must follow when communicating with consumers, including the time, place and manner of the communications, and prohibit unfair, deceptive, or abusive debt collection practices. Pursuant to the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act of 2010 (the “Dodd-Frank Act”), Congress transferred the Federal Trade Commission’s (“FTC”) role of administering the FDCPA to the Consumer Financial Protection Bureau (“CFPB”), along with certain other federal statutes, and gave the CFPB authority to implement regulations under the FDCPA. The FTC and the CFPB share enforcement responsibilities under the FDCPA.

In addition to the FDCPA, the federal laws that directly or indirectly apply to our business (including the regulations that implement these laws) include the following:

Dodd-Frank Act, including the Consumer Financial Protection Act (Title X of the Dodd-Frank Act, “CFPA”)	Servicemembers’ Civil Relief Act
Electronic Fund Transfer Act	Telephone Consumer Protection Act (“TCPA”)
Equal Credit Opportunity Act	Truth In Lending Act
Fair Credit Billing Act	U.S. Bankruptcy Code
Fair Credit Reporting Act (“FCRA”)	Wire Act
Federal Trade Commission Act (“FTCA”)	Credit CARD Act
Gramm-Leach-Bliley Act	Foreign Corrupt Practices Act
Health Insurance Portability and Accountability Act	

The Dodd-Frank Act was adopted to reform and strengthen regulation and supervision of the U.S. financial services industry. It contains comprehensive provisions governing the oversight of financial institutions, some of which apply

to us. Among other things, the Dodd-Frank Act established the CFPB, which has broad authority to implement and enforce “federal consumer financial law,” as well as authority to examine financial institutions, including credit issuers that may be sellers of

7

Table of Contents

receivables and debt buyers and collectors such as us, for compliance with federal consumer financial law. The CFPB has authority to prevent unfair, deceptive, or abusive acts or practices by issuing regulations or by using its enforcement authority without first issuing regulations. The Dodd-Frank Act also authorizes state officials to enforce regulations issued by the CFPB and to enforce the CFPA general prohibition against unfair, deceptive, and abusive acts or practices.

The CFPB's authorities include the ability to issue regulations under all significant federal statutes that affect the collection industry, including the FDCPA, FCRA, and others. In July 2016, the CFPB released an outline of proposals under consideration for its debt collection rulemaking. The proposals are aimed at ensuring debt collectors, among other things: collect the correct debt; limit excessive or disruptive communications; stop collecting or suing for debt without proper documentation; and provide documentation substantiating debt to a consumer upon demand. In addition to consulting with business representatives, the CFPB will continue to seek input from the public, consumer groups, industry, and other stakeholders before continuing the rulemaking process. In October 2018, the CFPB issued an agenda that included plans to issue a Notice of Proposed Rulemaking by March 2019 concerning debt collectors' and debt buyers' communications practices and consumer disclosures.

The Dodd-Frank Act also gave the CFPB supervisory and examination authority over a variety of institutions that may engage in debt collection, including us. Accordingly, the CFPB is authorized to supervise and conduct examinations of our business practices. The prospect of supervision has increased the potential consequences of noncompliance with federal consumer financial law.

The CFPB can conduct hearings, adjudication proceedings, and investigations, either unilaterally or jointly with other state and federal regulators, to determine if federal consumer financial law has been violated. The CFPB has authority to impose monetary penalties for violations of applicable federal consumer financial laws (including the CFPA, FDCPA, and FCRA, among other consumer protection statutes), require remediation of practices, and pursue enforcement actions. The CFPB also has authority to obtain cease and desist orders (which can include orders for restitution or rescission of contracts, as well as other kinds of affirmative relief), costs, and monetary penalties ranging from \$5,000 per day for ordinary violations of federal consumer financial laws to \$25,000 per day for reckless violations and \$1 million per day for knowing violations. In addition, where a company has violated Title X of the Dodd-Frank Act or CFPB regulations implemented under Title X of the Dodd-Frank Act, the Dodd-Frank Act empowers state Attorneys General and state regulators to bring civil actions to remedy violations of state law. The CFPB has been active in its supervision, examination and enforcement of financial services companies, including bringing enforcement actions, imposing fines and mandating large refunds to customers of several financial institutions for practices relating to debt collection practices.

On September 9, 2015, we entered into a consent order (the "Consent Order") with the CFPB in which we settled allegations arising from our practices between 2011 and 2015. We will continue to cooperate and engage with the CFPB and work to ensure compliance with the Consent Order, which terminates in September 2020. In addition, we are subject to ancillary state attorney general investigations related to similar debt collection practices.

In addition, the CFPB has issued guidance in the form of bulletins on debt collection and credit furnishing activities generally, including one that specifically addresses representations regarding credit reports and credit scores during the debt collection process, another that focuses on the application of the CFPA's prohibition of "unfair, deceptive, or abusive" acts or practices on debt collection and another that discusses the risks that in-person collection of consumer debt may create in violating the FDPCA and CFPA. The CFPB also accepts debt collection consumer complaints and released template letters for consumers to use when corresponding with debt collectors. The CFPB makes publicly available its data on consumer complaints. The Dodd-Frank Act also mandates the submission of multiple studies and reports to Congress by the CFPB, and CFPB staff regularly make speeches on topics related to credit and debt. All of these activities could trigger additional legislative or regulatory action. In addition, the CFPB has engaged in enforcement activity in sectors adjacent to our industry, impacting credit originators, collection firms, and payment processors, among others. The CFPB's enforcement activity in these spaces, especially in the absence of clear rules or regulatory expectations, can be disruptive to third parties as they attempt to define appropriate business practices. As a result, certain commercial relationships we maintain may be disrupted or impacted by changes in third-parties' business practices or perceptions of elevated risk relating to the debt collection industry.

Our activities are also subject to federal and state laws concerning identity theft, privacy, data security, the use of automated dialing equipment, and other laws related to consumers and consumer protection. In response to petitions filed by third parties, in July 2015, the Federal Communications Commission (“FCC”) released a declaratory ruling interpreting the TCPA, which could impact the way consumers may be contacted on their cellular phones and could impact our operations and financial results. The FCC is currently engaged in further rulemaking regarding the definition of an automatic telephone dialing system under the TCPA.

Table of Contents

In addition to the federal statutes detailed above, many states have general consumer protection statutes, laws, regulations, or court rules that apply to debt purchasing and collection. In a number of states and cities, we must maintain licenses to perform debt recovery services and must satisfy related bonding requirements. It is our policy to comply with all material licensing and bonding requirements. Our failure to comply with existing licensing requirements, changing interpretations of existing requirements, or adoption of new licensing requirements, could restrict our ability to collect in regions, subject us to increased regulation, increase our costs, or adversely affect our ability to collect our receivables.

State laws, among other things, also may limit the interest rate and the fees that a credit originator may impose on our consumers, limit the time in which we may file legal actions to enforce consumer accounts, and require specific account information for certain collection activities. By way of example, the California Fair Debt Buying Practices Act that directly applies to debt buyers, applies to accounts sold after January 1, 2014. The law requires debt buyers operating in the state to have in their possession specific account information before debt collection efforts can begin, among other requirements. Moreover, the New York State Department of Financial Services issued new debt collection regulations, which took effect in September 2015 and established new requirements for collecting debt in the state. In addition, other state and local requirements and court rulings in various jurisdictions may also affect our ability to collect.

The relationship between consumers and credit card issuers is also extensively regulated by federal and state consumer protection and related laws and regulations. These laws may affect some of our operations because the majority of our receivables originate through credit card transactions. The laws and regulations applicable to credit card issuers, among other things, impose disclosure requirements when a credit card account is advertised, when it is applied for and when it is opened, at the end of monthly billing cycles, and at year-end. Federal law requires, among other things, that credit card issuers disclose to consumers the interest rates, fees, grace periods, and balance calculation methods associated with their credit card accounts. Some laws prohibit discriminatory practices in connection with the extension of credit. If the originating institution fails to comply with applicable statutes, rules, and regulations, it could create claims and rights for consumers that would reduce or eliminate their obligations related to those receivables. When we acquire receivables, we generally require the credit originator or portfolio reseller to represent that they have complied with applicable statutes, rules, and regulations relating to the origination and collection of the receivables before they were sold to us.

Federal statutes further provide that, in some cases, consumers cannot be held liable for, or their liability is limited with respect to, charges to their credit card accounts that resulted from unauthorized use of their credit cards. These laws, among others, may give consumers a legal cause of action against us, or may limit our ability to recover amounts owing with respect to the receivables, whether or not we committed any wrongful act or omission in connection with the account.

These laws and regulations, and others similar to the ones listed above, as well as laws applicable to specific types of debt, impose requirements or restrictions on collection methods or our ability to enforce and recover certain of our receivables. Effects of the law, including those described above, and any new or changed laws, rules, or regulations, and reinterpretation of the same, may adversely affect our ability to recover amounts owing with respect to our receivables or the sale of receivables by creditors and resellers.

Cabot (Europe)

Our operations in Europe are affected by foreign statutes, rules and regulations. It is our policy to comply with these laws in all of our recovery activities.

Financial Conduct Authority Regulation. U.K. debt purchase and collections businesses are principally regulated by the Financial Conduct Authority (“FCA”), the UK Information Commissioner’s Office (“ICO”) and the UK Office of Communications (“OFCOM”). In March 2016, Cabot Credit Management Group Limited (“CCMG”), a Cabot subsidiary, was granted FCA authorization to conduct debt purchase and debt collection activities. CCMG appointed other Cabot subsidiaries to carry out debt-collecting and debt administration services on its behalf. CCMG assumes full regulatory responsibility for such entities. The FCA regards debt collection as a “high risk” activity and may therefore dedicate special resources to more intensive monitoring of businesses in this sector. The FCA Handbook sets out the FCA rules and other provisions. Firms wishing to carry on regulated consumer credit activities must comply with all applicable

sections of the FCA Handbook, including Customer Treatment principles, as well as the applicable consumer credit laws and regulat