CompuCredit Holdings Corp
Form 10-Q
November 05, 2010

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

For the quarterly period ended September 30, 2010

of

COMPUCREDIT HOLDINGS CORPORATION

a Georgia Corporation

IRS Employer Identification No. 58-2336689

SEC File Number 0-53717

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Atlanta, Georgia 30328

(770) 828-2000

CompuCredit's common stock, no par value per share, is registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 (the "Act").

CompuCredit (1) is required to file reports pursuant to Section 13 or Section 15(d) of the Act, (2) has filed all reports required to be filed by Section 13 or 15(d) of the Act during the preceding 12 months and (3) has been subject to such filing requirements for the past ninety days. CompuCredit Holdings Corporation is not yet required to file Interactive Data Files.

CompuCredit is a smaller reporting company and is not a shell company.

As of October 31, 2010, 35,754,189 shares of common stock, no par value, of the registrant were outstanding. (This excludes 2,252,388 loaned shares to be returned as of that date.)

COMPUCREDIT HOLDINGS CORPORATION
FORM 10-Q
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CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(Dollars in thousands)

	September 30, 2010 (Unaudited)	December 31, 2009
Assets		
Cash and cash equivalents (including restricted cash of $39,672 at September 30, 2010 and $5,636 at December 31, 2009)	$ 128,001	$ 190,655
Securitized earning assets	—	36,514
Loans and fees receivable:		
Loans and fees receivable, net (of $8,707 and $7,030 in deferred revenue and $16,823 and $15,030 in allowances for uncollectible loans and fees receivable at September 30, 2010 and December 31, 2009, respectively)	79,069	70,928
Loans and fees receivable pledged as collateral under structured financings, net (of $19,227 and $33,864 in deferred revenue and $30,799 and $38,414 in allowances for uncollectible loans and fees receivable at September 30, 2010 and December 31, 2009, respectively)	139,146	214,439
Loans and fees receivable, at fair value	12,227	42,299
Loans and fees receivable pledged as collateral under structured financings, at fair value	457,486	—
Investments in previously charged-off receivables	30,654	29,669
Investments in securities	58,653	2,629
Deferred costs, net	3,358	4,432
Property at cost, net of depreciation	23,397	32,263
Investments in equity-method investees	8,099	13,517
Intangibles, net	2,495	2,816
Goodwill	43,245	43,422
Income tax asset, net	—	32,695
Prepaid expenses and other assets	26,097	32,554
Total assets	$ 1,011,927	$ 748,832
Liabilities		
Accounts payable and accrued expenses	$ 62,594	$ 67,295
Notes payable associated with structured financings, at face value	113,496	164,368
Notes payable associated with structured financings, at fair value	451,141	—
Convertible senior notes (Note 10)	232,562	307,573
Deferred revenue	1,529	1,875
Income tax liability	63,804	—
Total liabilities	925,126	541,111
Commitments and contingencies (Note 11)		
Equity		
Common stock, no par value, 150,000,000 shares authorized: 46,250,658 shares issued and 38,009,115 shares outstanding at September 30, 2010 (including 2,252,388 loaned shares to be returned); and 58,596,545 shares issued and 49,970,111 shares outstanding at December 31, 2009 (including 2,252,388 loaned shares to be returned)	—	—
Additional paid-in capital	406,626	500,064
	(209,736)	(219,714)

Treasury stock, at cost, 8,241,543 and 8,626,434 shares at September 30, 2010 and December 31, 2009, respectively		
Accumulated other comprehensive loss	(3,901)	(3,293)
Retained deficit	(123,504)	(87,740)
Total shareholders' equity (Note 2)	69,485	189,317
Noncontrolling interests (Note 2)	17,316	18,404
Total equity	86,801	207,721
Total liabilities and equity (Note 2)	$ 1,011,927	$748,832

See accompanying notes.

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CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)
(Dollars in thousands, except per share data)

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
Interest income:				
Consumer loans, including past due fees	$60,609	$17,987	$213,976	$56,755
Other	451	325	820	906
Total interest income	61,060	18,312	214,796	57,661
Interest expense	(11,599)	(9,465)	(45,434)	(29,675)
Net interest income before fees and related income on earning assets and provision for losses on loans and fees receivable	49,461	8,847	169,362	27,986
Fees and related income on earning assets	112,605	58,890	394,098	142,462
Losses upon charge off of loans and fees receivable recorded at fair value	(86,971)	—	(391,615)	—
Provision for losses on loans and fees receivable recorded at net realizable value	(17,522)	(16,712)	(53,505)	(47,520)
Net interest income, fees and related income on earning assets	57,573	51,025	118,340	122,928
Other operating income (loss):				
Loss on securitized earning assets	—	(216,416)	—	(530,130)
Servicing income	1,621	21,999	5,447	92,873
Ancillary and interchange revenues	2,728	4,028	8,722	15,255
Gain on repurchase of convertible senior notes	5,681	—	28,374	160
Gain on buy-out of equity-method investee members	—	—	—	20,990
Equity in loss of equity-method investees	(1,372)	(2,170)	(11,043)	(12,185)
Total other operating income (loss)	8,658	(192,559)	31,500	(413,037)
Other operating expense:				
Salaries and benefits	7,568	12,182	26,928	40,257
Card and loan servicing	31,245	55,930	107,481	166,680
Marketing and solicitation	6,545	4,418	17,688	12,472
Depreciation	3,371	4,520	10,487	16,161
Goodwill impairment	—	—	—	20,000
Other	15,577	22,840	54,970	73,343
Total other operating expense	64,306	99,890	217,554	328,913
Income (loss) from continuing operations before income taxes	1,925	(241,424)	(67,714)	(619,022)
Income tax (expense) benefit	(600)	2,791	(1,700)	123,381
Income (loss) from continuing operations	1,325	(238,633)	(69,414)	(495,641)
Discontinued operations:				
Loss on discontinued operations before income taxes	—	—	—	(6,599)
Income tax benefit	—	—	—	2,310
Loss on discontinued operations	—	—	—	(4,289)
Net income (loss)	1,325	(238,633)	(69,414)	(499,930)
Net loss (income) attributable to noncontrolling interests	436	(778)	(565)	13,658
Net income (loss) attributable to controlling interests	$1,761	$(239,411)	$(69,979)	$(486,272)

Income (loss) from continuing operations attributable to controlling interests per common share—basic	$0.05	$(5.02)	$(1.70)	$(10.11)
Income (loss) from continuing operations attributable to controlling interests per common share—diluted	$0.05	$(5.02)	$(1.70)	$(10.11)
Loss on discontinued operations attributable to controlling interests per common share—basic	$—	$—	$—	$(0.09)
Loss on discontinued operations attributable to controlling interests per common share—diluted	$—	$—	$—	$(0.09)
Net income (loss) attributable to controlling interests per common share—basic	$0.05	$(5.02)	$(1.70)	$(10.20)
Net income (loss) attributable to controlling interests per common share—diluted	$0.05	$(5.02)	$(1.70)	$(10.20)

See accompanying notes.

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statements of Shareholders' Equity
For the Nine Months Ended September 30, 2010 (Unaudited)
(Dollars in thousands)

	Common Stock								
	Shares Issued	Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Loss	Retained Deficit	Noncontrolling Interests	Comprehensive Loss	Total Equity
Balance at December 31, 2009	58,596,545	$ —	$ 500,064	$ (219,714)	$ (3,293)	$ (87,740)	$ 18,404		$ 207,721
Cumulative effect of accounting pronouncement adoption (see Note 2)	—	—	—	—	—	34,449	3,231		37,680
Retirement of shares	(12,180,604)		(85,264)	—	—	—	—		(85,264)
Use of treasury stock for stock-based compensation plans	(303,216)	—	(10,368)	10,602	—	(234)	—		—
Issuance of restricted stock, net of forfeiture	137,933	—	—	—	—	—	—		—
Amortization of deferred stock-based compensation costs	—	—	7,055	—	—	—	—		7,055
Purchase of treasury stock	—	—	—	(624)	—	—	—		(624)
Tax effects of stock-based compensation plans	—	—	(1,443)	—	—	—	—		(1,443)
Repurchase of noncontrolling interests	—	—	(3,418)	—	—	—	(4,119)		(7,537)
Distributions to owners of noncontrolling interests	—	—	—	—	—	—	(765)		(765)
Net (loss) income	—	—	—	—	—	(69,979)	565	$ (69,414)	(69,414)

Foreign currency translation adjustment, net of tax	—	—	—	—	(608)	—	—	(608)	(608)
Comprehensive loss	—	—	—	—	—	—	—	$ (70,022)	—
Balance at September 30, 2010	46,250,658	$ —	$ 406,626	$ (209,736)	$ (3,901)	$ (123,504)	$ 17,316		$ 86,801

See accompanying notes.

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
(Dollars in thousands)

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
Net income (loss)	$1,325	$(238,633)	$(69,414)	$(499,930)
Other comprehensive income (loss):				
Foreign currency translation adjustment	3,069	(2,484)	(609)	10,763
Income tax (expense) benefit related to other comprehensive loss	—	1	1	(11,906)
Comprehensive income (loss)	4,394	(241,116)	(70,022)	(501,073)
Comprehensive loss (income) attributable to noncontrolling interests	436	(778)	(565)	13,660
Comprehensive income (loss) attributable to controlling interests	$4,830	$(241,894)	$(70,587)	$(487,413)

See accompanying notes.

CompuCredit Holdings Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(Dollars in thousands)

	For the Nine Months Ended September 30, 2010	2009
Operating activities		
Net loss	$ (69,414)	$ (499,930)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation expense	10,487	16,202
Impairment of goodwill	—	23,483
Losses upon charge off of loans and fees receivable recorded at fair value	391,615	—
Provision for losses on loans and fees receivable	53,505	48,212
Amortization and impairment of intangibles	321	1,518
Accretion of deferred revenue	(346)	(21,500)
Accretion of discount on convertible senior notes	7,022	7,572
Stock-based compensation expense	7,055	6,738
Retained interests adjustments, net	—	960,764
Unrealized gain on loans and fees receivable and underlying notes payable held at fair value	(217,882)	—
Unrealized gain on trading securities	(301)	(309)
Gain on repurchase of convertible senior notes	(28,374)	(160)
Loss on equity-method investments	11,043	—
Gain on buy-out of equity-method investee members	—	(20,990)
Changes in assets and liabilities, exclusive of business acquisitions:		
(Increase) decrease in uncollected fees on loans receivable	(5,594)	6,870
Decrease (increase) in JRAS auto loans receivable	31,168	(17,575)
Decrease in deferred costs	684	958
Increase (decrease) in income tax liability	95,222	(126,303)
Decrease in prepaid expenses	6,463	6,177
Decrease in accounts payable and accrued expenses	(6,649)	(34,721)
Other	8,291	4,661
Net cash provided by operating activities	294,316	361,667
Investing activities		
Purchase of third-party interest in equity-method investee	—	(19,542)
(Increase) decrease in restricted cash	(19,954)	16,274
Proceeds from equity-method investees	5,145	53,483
Investments in securitized earning assets	—	(448,544)
Proceeds from securitized earning assets	—	209,695
Investments in earning assets	(786,663)	(668,598)
Proceeds from earning assets	926,704	684,158
Acquisitions of assets	—	(621)
Purchases and development of property, net of disposals	(1,667)	(2,444)
Net cash provided by (used in) investing activities	123,565	(176,139)
Financing activities		
Noncontrolling interests distributions, net	(765)	(774)
Purchases of treasury stock	(624)	(119)
Purchases of noncontrolling interests	(7,537)	(1,096)

Purchase of outstanding stock subject to tender offer		(85,264)		—
Proceeds from borrowings		8,143		52,897
Repayments of borrowings		(428,250)		(195,755)
Net cash used in financing activities		(514,297)		(144,847)
Effect of exchange rate changes on cash		(274)		760
Net (decrease) increase in unrestricted cash		(96,690)		41,441
Unrestricted cash and cash equivalents at beginning of period		185,019		74,515
Unrestricted cash and cash equivalents at end of period	$	88,329	$	115,956
Supplemental cash flow information				
Effect of adoption of accounting pronouncements on restricted cash	$	(14,082)	$	—
Cash paid for interest	$	39,911	$	23,284
Net cash income tax (refunds) payments	$	(93,456)	$	131
Supplemental non-cash information				
Notes payable associated with capital leases	$	684	$	1,011
Issuance of stock options and restricted stock	$	1,127	$	1,129

See accompanying notes.

CompuCredit Holdings Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements
September 30, 2010

1. Basis of Presentation

We have prepared our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Securities and Exchange Commission ("SEC") Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete consolidated financial statements. In the opinion of management, all normal recurring adjustments considered necessary to fairly state the results for the interim periods presented have been included.

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our condensed consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Certain estimates, such as credit losses, payment rates, costs of funds, discount rates and the yields earned on credit card receivables significantly affect the reported amount of two categories of credit card receivables that we report at fair value and our notes payable associated with structured financings, at fair value, as reported on our condensed consolidated balance sheet at September 30, 2010, as well as the reported fair value of our securitized earning assets on our consolidated balance sheet at December 31, 2009; these estimates likewise affect our changes in fair value of loans and fees receivable recorded at fair value and changes in fair value of notes payable associated with structured financings recorded at fair value categories within our fees and related income on earning assets line item on our condensed consolidated statement of operations for the three and nine months ended September 30, 2010, as well as our reported loss on retained interests in credit card receivables securitized which is a component of loss on securitized earning assets on our condensed consolidated statement of operations for the three and nine months ended September 30, 2009. Additionally, estimates of future credit losses on our loans and fees receivable that we report at net realizable value, rather than fair value, have a significant effect on two categories of such loans and fees receivable, net, that we show on our condensed consolidated balance sheets, as well as on the provision for losses on loans and fees receivable within our condensed consolidated statements of operations. Operating results for the three and nine months ended September 30, 2010 are not indicative of what our results will be for the year ending December 31, 2010.

We have reclassified certain amounts in our prior period condensed consolidated financial statements to conform to current period presentation, and we have eliminated all significant intercompany balances and transactions for financial reporting purposes.

In connection with our consideration of a potential spin-off of our U.S. and U.K. micro-loan businesses, one of our subsidiaries, Purpose Financial Holdings, Inc. ("Purpose Financial"), filed a Form 10 Registration Statement and a related Information Statement with the SEC on January 4, 2010 and amended the Form 10 Registration Statement and related Information Statement in response to SEC comments most recently on May 28, 2010. The spin-off remains subject to a number of conditions, including, among others:

- a recommendation by our management to our Board of Directors to approve the spin-off;
- approval from our Board of Directors;
- the SEC's declaration of Purpose Financial's registration statement on Form 10 to be effective;

- our and Purpose Financial’s receipt of any required permits, registrations and consents required under the securities or blue sky laws of states or other political subdivisions of the U.S. or of foreign jurisdictions in connection with the spin-off;
- the continued effectiveness of the private letter ruling that we received from the Internal Revenue Service;
- NASDAQ’s approval for listing of Purpose Financial’s common stock, subject to official notice of issuance;

- the transfer of our micro-loan businesses, and the associated licenses and registrations relating to these businesses, to Purpose Financial;
- the execution by the parties of separation and distribution agreements, transition services agreements, services agreements, employee matters agreements, tax sharing agreements, sublease and other appropriate agreements; and
- the lack of any effective order, injunction or decree issued by any court of competent jurisdiction or other legal restraint or prohibition preventing consummation of the spin-off or any of the transactions related thereto, including the transfers of assets and liabilities contemplated by the separation and distribution agreement.

We cannot assure you that any or all of these conditions will be met.

2. Significant Accounting Policies and Condensed Consolidated Financial Statement Components

The following is a summary of significant accounting policies we follow in preparing our condensed consolidated financial statements, as well as a description of significant components of our condensed consolidated financial statements.

Restricted Cash

Restricted cash includes (1) certain collections on receivables within our Credit Cards segment (only as of the September 30, 2010 condensed consolidated balance sheet date pursuant to the accounting rules changes described in “Asset Securitization” below) and Auto Finance segment, the cash balances of which are required to be distributed to note holders under our debt facilities, and (2) cash collateral balances underlying standby letters of credit that have been issued in favor of certain regulators in connection with our retail micro-loan activities.

Asset Securitization

At December 31, 2009, most of our credit card receivables were held by off-balance-sheet securitization trusts. In June 2009, however, the Financial Accounting Standards Board (the “FASB”) issued new accounting rules that resulted in the consolidation of our securitization trusts onto our consolidated balance sheet effective as of January 1, 2010. As a result of these new accounting rules, cash and credit card receivables held by our securitization trusts and debt issued from those entities are presented as assets and liabilities on our condensed consolidated balance sheet as of September 30, 2010. Throughout the notes to our condensed consolidated financial statements, we use the term “securitizations” to refer to pre-2010 activities of our then-categorized off-balance-sheet securitization trusts (qualifying special purposes entities, or “QSPEs”). In contrast, we use the term “structured financings” to refer to non-recourse, asset-backed, on-balance-sheet debt financings either undertaken prior to 2010 or as accounted for under new accounting guidance effective as of January 1, 2010.

Loans and Fees Receivable

Our loans and fees receivable include: (1) loans and fees receivable, at fair value; (2) loans and fees receivable pledged as collateral under structured financings, at fair value; (3) loans and fees receivable, net; and (4) loans and fees receivable pledged as collateral under structured financings, net;.

Loans and Fees Receivable, at Fair Value. Our loans and fees receivable, at fair value, represent our de-securitized and reconsolidated lower-tier credit card receivables that are valued at fair value in our condensed consolidated financial statements, while our loans and fees receivable pledged as collateral under structured financings, at fair value, represent the receivables underlying our remaining credit card securitization trusts that were consolidated pursuant to accounting rules changes on January 1, 2010. Further details concerning our loans and fees receivable held at fair value are presented within Note 9, "Fair Value of Assets and Liabilities."

Loans and Fees Receivable, Net. Our two categories of loans and fees receivable, net, currently consist of receivables carried at net realizable value associated with our retail and Internet micro-loan activities, our auto finance business and credit card accounts opened under our Investment in Previously Charged-off Receivables segment's balance transfer program. This latter category of balance transfer program receivables is included as a component of our Credit Card segment data and aggregated $14.5 million (net of allowances for uncollectible loans and fees receivable and deferred revenue) or 2.1% of our consolidated loans and fees receivable (net or at fair value) as of September 30, 2010.

As applicable, we show loans and fees receivable net of both an allowance for uncollectible loans and fees receivable and unearned fees (or "deferred revenue") in accordance with applicable accounting rules. We also divide our loans and fees receivable, net, into two separate categories on our condensed consolidated balance sheet: (1) those that are unencumbered by asset-backed debt; and (2) those that are pledged as collateral for non-recourse asset-backed debt facilities.

The components of our aggregated categories of loans and fees receivable, net (in millions) as of the date of each of our condensed consolidated balance sheets are as follows:

	Balance at December 31, 2009	Additions	Subtractions	Balance at September 30, 2010
Loans and fees receivable, gross	$ 379.7	$ 846.4	$ (932.4)	$ 293.7
Deferred revenue	(40.9)	(50.9)	63.9	(27.9)
Allowance for uncollectible loans and fees receivable	(53.4)	(53.5)	59.3	(47.6)
Loans and fees receivable, net	$ 285.4	$ 742.0	$ (809.2)	$ 218.2

As of September 30, 2010, the weighted average remaining accretion period for the $27.9 million of deferred revenue reflected in the above tables is 16.6 months.

A roll-forward of our allowance for uncollectible loans and fees receivable, net (in millions) is as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Balance at beginning of period	$(48.5)	$(56.7)	$(53.4)	$(55.8)
Provision for losses on loans and fees receivable recorded at net realizable value	(17.5)	(16.7)	(53.5)	(47.5)
Charge offs	20.4	15.0	66.6	47.8
Recoveries	(2.0)	(0.9)	(7.3)	(3.8)
Balance at end of period	$(47.6)	$(59.3)	$(47.6)	$(59.3)

Investments in Previously Charged-Off Receivables

The following table shows (in thousands) a roll-forward of our investments in previously charged-off receivables activities:

	For the Three Months Ended September 30, 2010	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2010	For the Nine Months Ended September 30, 2009
Unrecovered balance at beginning of period	$ 33,297	$ 59,271	$ 29,669	$ 47,676
Acquisitions of defaulted accounts	5,839	8,776	22,409	40,427
Cash collections	(17,158)	(54,668)	(45,858)	(82,889)
Cost-recovery method income recognized on defaulted accounts (included as a component of fees and related income on earning assets on our condensed consolidated statements of operations)	8,676	16,475	24,434	24,640
Unrecovered balance at end of period	$ 30,654	$ 29,854	$ 30,654	$ 29,854
Estimated remaining collections (“ERC”) (1)	$ 98,829	$ 86,946	$ 98,829	$ 86,946

(1) We anticipate collecting 44.7% of the ERC of the existing accounts over the next 12 months, with the balance to be collected thereafter.

We estimate the life of each pool of previously charged-off receivables acquired by us generally to be between 24 and 36 months for normal delinquency charged-off accounts and approximately 60 months for Chapter 13 Bankruptcy-related debt.

Previously charged-off receivables held as of September 30, 2010 are comprised principally of: normal delinquency charged-off accounts; charged-off accounts associated with Chapter 13 Bankruptcy-related debt; and charged-off accounts acquired through our Investments in Previously Charged-Off Receivables segment’s balance transfer program prior to such time as credit cards are issued relating to the program’s underlying accounts. At September 30, 2010, $10.4 million of our investments in previously charged-off receivables balance was comprised of previously charged-off receivables that our Investments in Previously Charged-Off Receivables segment purchased from our other consolidated subsidiaries, and in determining our net income or loss as reflected on our consolidated statements of operations, we eliminate all material intercompany profits that are associated with these transactions. Although we eliminate all intercompany profits associated with these purchases, we do not eliminate the corresponding purchases from our condensed consolidated balance sheet categories so as to better reflect the ongoing business operations of each of our reportable segments and because the amounts represent just 1.0% of our consolidated total assets.

For balance transfer program accounts, we include receivables in the above table until such time that the accounts qualify for a credit card issuance under the program. Under our Investments in Previously Charged-Off Receivables segment’s cost recovery method, there is no remaining basis in such balance transfer program accounts at the time of card issuance. Upon card issuance, all further activity with respect the accounts (e.g. cardholder purchases, payments, receivables levels, cash flows, finance charge and fee income and charge-off activities) is reported within our Credit Cards segment, with the exception of any cash flows representing further repayment of the acquired contractual charged-off balance, which continue to be reported as cash collections and cost-recovery method income in the above table.

Comparisons of data as of and for the three months ended September 30, 2010 with data as of and for the three months ended September 30, 2009 are affected by a 2005 forward flow contract into which our Investment in Previously Charged-off Receivables segment had entered to sell previously charged-off receivables to Encore Capital Group, Inc. ("Encore")—a forward flow contract that subsequently terminated in the third quarter of 2009. In that quarter, we resolved disputes that had arisen with Encore under the contract, thereby resulting in the recognition of $21.2 million in then-deferred revenue in the third quarter of 2009 and a corresponding release of $8.7 million in escrowed restricted cash—both in exchange for Encore's purchase of previously charged-off credit card receivables that had been offered to Encore throughout the period covered by the forward flow agreement (and that had built up on our consolidated balance sheet throughout the latter half of 2008 and through September 2009) and Encore's resumed offering of volumes of previously charged-off receivables it has purchased for placement under our balance transfer program. Inclusive of all liabilities extinguished and amounts received and paid in connection with our settlement with Encore, the settlement resulted in a net pre-tax gain of $11.0 million on our consolidated statement of operations for three months ended September 30, 2009.

Investments in Securities

We periodically invest in debt and equity securities, some of which we classify as trading securities and with respect to which we include realized and unrealized gains and losses in earnings, and some of which we classify as held to maturity or available for sale. Additionally, we occasionally have received distributions of debt securities from our equity-method investees ($0.7 million held at September 30, 2010), and we have classified such distributed debt securities as held to maturity. As appropriate, we may invest in securities we believe provide returns in excess of those realized in our cash accounts. Such was the case in the first quarter of 2010 during which we invested $75.0 million in publicly traded bond funds whose investment objectives are to invest in highly rated, investment-grade securities. The carrying values (in thousands) of our investments in debt and equity securities are as follows:

	As of	
	September 30, 2010	December 31, 2009
Held to maturity:		
Investments in debt securities	$ 714	$ 2,060
Available for sale:		
Investments in equity securities	1,672	—
Trading:		
Investments in debt securities	55,695	—
Investments in equity securities	572	569
Total investments in debt and equity securities	$ 58,653	$ 2,629

Prepaid Expenses and Other Assets

Prepaid expenses and other assets include amounts paid to third parties for marketing and other services. Also included are (1) various deposits (totaling $1.1 million and $6.2 million as of September 30, 2010 and December 31, 2009, respectively) required to be maintained with our third-party issuing bank partners and retail electronic payment network providers (including $0.4 million and $4.9 million as of September 30, 2010 and December 31, 2009, respectively, associated with our ongoing servicing efforts in the U.K.), (2) vehicle inventory ($0.6 million and $4.1 million as of September 30, 2010 and December 31, 2009, respectively) held by our buy-here, pay-here auto operations that we expense as cost of goods sold (within fees and related income on earning assets on our condensed consolidated statements of operations) as we earn associated sales revenues, and (3) and deposits of $7.7 million and $10.0 million at September 30, 2010 and December 31, 2009, respectively, held at a former third-party issuing bank partner (Columbus Bank and Trust Company), the September 30, 2010 balance of which is to be returned to us upon notification by the Federal Deposit Insurance Corporation (the "FDIC") to Columbus Bank and Trust Company of the FDIC's concurrence with our computations of credits and refunds that we provided to credit card customers pursuant to our December 2008 settlement of litigation with the FDIC and the Federal Trade Commission (the "FTC"). Having fully complied with the FDIC and FTC restitution requirements through our provided cardholder credits and refunds, no contingencies to the release of the $7.7 million deposit exist beyond the communication by the FDIC to Columbus Bank and Trust Company of the FDIC's concurrence with our provided restitution credits and refunds.

Deferred Costs

The principal components of our deferred costs historically have been unamortized costs associated with our (1) issuances of convertible senior notes and other debt facilities and (2) receivables origination activities. On January 1, 2009, we were required to adopt a GAAP pronouncement that resulted in the reclassification of $4.8 million of deferred loan costs associated with our convertible senior notes as a reduction to equity. See Note 10, "Convertible Senior Notes and Notes Payable," for additional effects of our adoption of this pronouncement.

Income Taxes

We conduct business globally, and as a result, one or more of our subsidiaries files U.S. federal, state and/or foreign income tax returns. In the normal course of business we are subject to examination by taxing authorities throughout the world, including such major jurisdictions as the U.S., the U.K., and the Netherlands. With a few exceptions, we are no longer subject to U.S. federal, state, local, or foreign income tax examinations for years prior to 2007. Currently, we are under audit by various jurisdictions for various years, including by the Internal Revenue Service for the 2007 and 2008 tax years. Although the audits have not been concluded, we do not expect any changes to our reported tax positions in those years that would have a material effect on our consolidated financial statements.

We recognize potential accrued interest and penalties related to unrecognized tax benefits in income tax expense. We recognized $0.6 million and $1.8 million in potential interest and penalties associated with uncertain tax positions during the three and nine months ended September 30, 2010, respectively, compared to $0.6 million and $2.0 million during the three and nine months ended September 30 2009, respectively. To the extent such interest and penalties are not assessed as a result of a resolution of the underlying tax position, amounts accrued will be reduced and reflected as a reduction of income tax expense. We recognized such a reduction in the amount of $2.0 million in the three months ended September 30, 2010 related to the closing of statutes of limitations.

We generally do not provide for income taxes on the undistributed earnings of our U.K. Internet micro-loan subsidiaries because we intend to reinvest these earnings indefinitely to finance foreign activities. Because this treatment is premised on our future plans and expectations of future events, the possibility exists that amounts we declare as indefinitely reinvested offshore may ultimately be repatriated. For instance, the actual cash needs of our U.S. entities may exceed our current expectations, or the actual cash needs of our foreign entities may be less than our current expectations. These additional foreign earnings could be subject to additional tax if remitted, or deemed remitted, as a dividend, in the year in which we determine that amounts are no longer intended to be indefinitely reinvested offshore. Such a deemed remittance occurred in the three and nine months ended September 30, 2010 due to expiration of a long-standing U.S. income tax deferral provision which historically had shielded active finance company income earned in foreign jurisdictions from U.S. income tax. Although the active finance company income provisions expired for taxable years beginning on or after January 1, 2010, the U.S. Congress currently is working on legislation that would retroactively extend the active finance company income exception and permit retroactive and ongoing deferral of such income. Our specific foreign income source that previously had been protected from U.S. income taxation by reason of the active finance company income exception is the income earned by our U.K. Internet micro-loan operations. Although we cannot and did not assume enactment of laws to extend the active finance company income exception, the expiration of the exception had no effect on our effective tax rate during the three and nine months ended September 30, 2010 due to the effects of valuation allowances that we maintain against net deferred tax assets.

Our overall effective tax rates (computed considering results for both continuing and discontinued operations before income taxes in the aggregate) were 31.2% and -2.5% for three and nine months ended September 30, 2010, respectively, compared to 1.2% and 20.1% for the three and nine months ended September 30, 2009, respectively. The variations in our effective tax rates between these periods are substantially related to (1) fluctuations in our pre-tax earnings and losses, (2) the U.K. tax expense exceeding the recognized tax benefits on our U.S. losses, after valuation allowances and (3) interest accruals (net of releases) on our unrecognized tax benefits. The effects of changes in valuation allowances provided against income statement-oriented U.S. federal, foreign and state deferred tax assets were increases of $5.2 million and $23.2 million in valuation allowances, respectively, during the three and nine months ended September 30, 2010, versus corresponding increases of $85.1 million and $95.8 million in valuation allowances during the three and nine months ended September 30, 2009, respectively.

Fees and Related Income on Earning Assets

Fees and related income on earning assets primarily include: (1) lending fees associated with our retail and Internet micro-loan activities; (2) fees associated with our credit card receivables during periods in which we hold them on balance sheet; (3) changes in the fair value of loans and fees receivable recorded at fair value; (4) changes in fair value of notes payable associated with structured financings recorded at fair value; (5) income on our investments in previously charged-off receivables; (6) gross profits and losses from auto sales within our Auto Finance segment; (7) gains associated with our investments in securities; and (8) gains realized in the three months ended September 30, 2010 associated with our settlement of litigation with Columbus Bank and Trust, one of our former third-party credit card issuing bank partners, and its parent corporation Synovus Financial Corporation (collectively, “CB&T”) as further discussed in Note 11, “Commitments and Contingencies.”

The components (in thousands) of our fees and related income on earning assets are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Retail micro-loan fees	$18,490	$19,393	$53,756	$52,635
Internet micro-loan fees	25,910	18,636	65,965	45,528
Fees on credit card receivables held on balance sheet	5,002	—	20,861	—
Changes in fair value of loans and fees receivable recorded at fair value(1)	61,183	—	186,846	—
Changes in fair value of notes payable associated with structured financings recorded at fair value	(19,158)	—	31,036	—
Income on investments in previously charged-off receivables	8,676	16,475	24,434	24,640
Gross (loss) profit on auto sales	(478)	4,274	(2,127)	17,883
Gains on investments in securities	153	146	301	309
Gains upon litigation settlement with former third-party issuing bank partner	12,150	—	12,150	—
Other	677	(34)	876	1,467
Total fees and related income on earning assets	$112,605	$58,890	$394,098	$142,462

(1) The above changes in fair value of loans and fees receivable recorded at fair value excludes the impact of charge offs associated with these receivables which are separately stated on our condensed consolidated statements of operations. See Note 9, “Fair Values of Assets and Liabilities,” for further discussion of these receivables and their effects on our condensed consolidated statements of operations.

Loss on Securitized Earning Assets

Loss on securitized earning assets is the net of (1) securitization gains, (2) loss on retained interests in credit card receivables securitized, and (3) returned-check, cash advance and certain other fees associated with our securitized credit card receivables, all of which are detailed (in thousands) in the following table. This category on our condensed consolidated statement of operations is not applicable in 2010 given our consolidation of all of our former off-balance-sheet securitization trusts as required by accounting rules changes effective at the beginning of 2010.

	For the Three Months Ended September 30, 2009	For the Nine Months Ended September 30, 2009
Securitization gains	$113,961	$113,961
Loss on retained interests in credit card receivables securitized	(334,035)	(657,869)
Fees on securitized receivables	3,658	13,778
Total loss on securitized earning assets	$(216,416)	$(530,130)

Recent Accounting Pronouncements

In June 2010, the FASB issued new disclosure rules related to the allowance for credit losses and credit quality of financing receivables. The new requirements are intended to require an entity to provide a greater level of disaggregated information about the credit quality of its financing receivables and its allowance for credit losses, including a roll-forward of activity in the allowance and disclosure about credit quality indicators, past due information, and modifications of its financing receivables. The new disclosure requirements are effective for interim and annual reporting periods ending on or after December 15, 2010.

In January 2010, the FASB issued new rules concerning fair value measurement disclosures. The new disclosures require that we discuss the valuation techniques and inputs used to develop our fair value measurements and the effect that unobservable inputs may have on those measurements. Additional disclosure enhancements include disclosures of transfers in and/or out of Level 1, 2 or 3 and the reasons for those transfers. The enhanced disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements, which are effective for interim and annual reporting periods beginning after December 15, 2010. The adoption of these new disclosure requirements that are effective for us in 2010 are reflected in our accompanying notes to the condensed consolidated financial statements.

In October 2009, the FASB issued new rules providing that at the date of issuance, a share-lending arrangement entered into on an entity's own shares in contemplation of a convertible debt offering or other financing is required to be measured at fair value and recognized as a debt issuance cost in the financial statements of the entity. The debt issuance cost is required to be amortized using the effective interest method over the life of the financing arrangement as interest cost. The new rules also provide that the loaned shares are excluded from basic and diluted earnings per share calculations unless default of the share-lending arrangement occurs, at which time the loaned shares would be included in these calculations. These new rules are effective for fiscal years, and interim periods within those years, beginning after December 15, 2009, are to be applied retrospectively to all arrangements outstanding on the effective date, and apply to loaned shares issued in connection with our November 2005 convertible senior notes. Our implementation of these new rules had no effect on our consolidated financial statements during any period presented.

In June 2009, the FASB issued new accounting rules that, in addition to requiring certain new securitization and structured financing-related disclosures that we have incorporated into our condensed consolidated financial statements, resulted in the consolidation of our securitization trusts onto our condensed consolidated balance sheet effective as of January 1, 2010. As a result of these new accounting rules, cash and credit card receivables held by our securitization trusts and debt issued from those entities are presented as assets and liabilities on our condensed consolidated balance sheet effective on that date. Moreover, after adoption of these new accounting rules, we no longer reflect our securitization trusts' results of operations within loss on retained interests in credit card receivables securitized, but instead report interest income and provisions for loan losses (as well as gains and/or losses associated with fair value changes) with respect to the credit card receivables held within our securitization trusts; similarly, we separately report interest expense (as well as gains and/or losses associated with fair value changes) with respect to the debt issued from the securitization trusts. Lastly, because we account for our securitization transactions under the new rules as secured borrowings rather than asset sales, we present the cash flows from these transactions as cash flows from financing activities, rather than as cash flows from investing activities. As noted on our condensed consolidated statement of equity for the nine months ended September 30, 2010, our January 1, 2010 adoption of these rules resulted in an increase in total equity of $37.7 million.

In May 2008, the FASB issued new rules addressing convertible instruments that may be settled in cash upon conversion (including partial cash settlement). These rules address instruments commonly referred to as Instrument C type instruments. Those instruments essentially require the issuer to settle the principal amount in cash and the conversion spread in cash or net shares at the issuer's option. These rules are effective for fiscal periods beginning after December 15, 2008, did not permit early application, and are required to be applied retrospectively to all periods presented. Our January 1, 2009 adoption of these rules resulted in an increase in total equity of $56.1 million.

Subsequent Events

We evaluate events that occur subsequent to our condensed consolidated balance sheet date but before our condensed consolidated financial statements are issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence with respect to conditions that existed at the balance sheet date, including the estimates inherent in the process of preparing financial statements; and (2) nonrecognized, or those that provide evidence with respect to conditions that did not exist at the balance sheet date but arose subsequent to that date. We have evaluated subsequent events, and based on our review, we have not identified any recognized or nonrecognized subsequent events that would have required adjustments to or disclosures in our condensed consolidated financial statements.

3. Discontinued Operations

In May 2009, we discontinued our Retail Micro-Loans segment's Arkansas operations based on regulatory opposition we faced within that state. Reflecting our discontinued Arkansas operations, the components (in thousands) of our discontinued operations are as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2010	2009	2010	2009
Net interest income, fees and related income on earning assets	$ —	$ —	$ —	$ 1,684
Other operating expense	—	—	—	2,021
Estimated loss upon sale	—	—	—	2,779
Goodwill impairment	—	—	—	3,483
Loss before income taxes	—	—	—	(6,599)
Income tax benefit	—	—	—	