UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. CONN'S, INC. AND MICHAEL J. POPPE, Defendants.	Civil Action No. 4:19-cv-2534

COMPLAINT

For its Complaint against Defendants Conn's Inc. ("Conn's") and Michael J. Poppe, Plaintiff Securities and Exchange Commission ("SEC") alleges as follows:

SUMMARY

1. Conn's is a specialty retailer that offers consumer goods and credit financing, primarily to credit-constrained customers (*i.e.* customers with low credit scores who have difficulty obtaining credit from traditional lenders). From the second quarter of fiscal 2013 through the second quarter of fiscal 2015 (quarters ended July 31, 2012 – July 31, 2014)[1] (the "Relevant Period"), Defendants understated the allowance for doubtful accounts and overstated income on Conn's financial statements. These errors resulted from: (1) Conn's use of a model to forecast its allowance for doubtful accounts that included management bias; and (2) the negligent application of that model by Conn's management, including Poppe, then the Chief Operating Officer of Conn's.

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1 Conn's operates on a retail fiscal calendar, ending on January 31; for example, fiscal 2013 ran from February 1, 2012 through January 31, 2013.

2. The model used by Conn's was called a "roll rate" model, which measures potential credit portfolio losses by segmenting the portfolio into delinquency buckets (current, 30+ days delinquent, 60+ days delinquent, etc.) and applying a roll rate to each segment. A roll rate is a measure for the percentage of receivables that will migrate into the next delinquency bucket in the following month. Although varying methodologies may be used to calculate roll rates, the calculations are generally based on actual roll rates from a previous time period (month, quarter, etc.) or an average of several recent time periods.

3. The roll rates that Conn's used in its model during the Relevant Period were not based on a historical average or calculation, but were instead hard-coded plugs (*i.e.,* round numbers manually entered into the model) reflecting then current management's unduly optimistic future expectations. Those expectations were not reasonable in light of Conn's operations and results at the time. During the Relevant Period, Conn's expanded lending to customers with poor credit and/or no collections history with or loyalty to Conn's. This approach resulted in higher delinquency rates and a riskier, more difficult to collect credit portfolio. Instead of increasing the future roll rates in response to the additional risks, Conn's plugged in unreasonably optimistic roll rates that were lower than recent or average actual historical roll rates. As a result, Conn's failed to adequately reserve for its riskier credit portfolio.

4. This conduct had the effect of lowering Conn's bad debt expense for an extended period of time — Conn's actual charge-offs (receivables more than 209 days past due that Conn's deemed uncollectible) were higher than projected/reserved charge-offs for 14 consecutive quarters (spanning three-and-a-half years), including every quarter in the Relevant Period.

5. In the second quarter of fiscal 2015, Conn's finally corrected its course. At that time, it began to build up its allowance for doubtful accounts by applying more conservative assumptions to the roll rate model. On September 2, 2014 Conn's announced its results for the quarter, which included a higher-than-expected provision for bad debt. In heavy trading following the earnings call, Conn's stock closed 30 percent down. In the third quarter of fiscal 2015, Conn's removed the subjective assumptions from its reserve calculation altogether. It replaced management's plugs with two-year same-month historical average roll rates. This change caused a $20 million increase to the reserve and resulted in a net loss of $0.08 per share compared to earnings of $0.66 per share in the prior-year quarter. The charge was announced with the quarterly results on the December 9, 2014 earnings call. Conn's stock price dropped 41 percent that day.

6. Since the third quarter of fiscal 2015, Conn's has replaced all of its senior management team and it no longer utilizes a roll rate model to calculate its allowance for doubtful accounts.

JURISDICTION AND VENUE

7. The SEC brings this action under Section 20(b) of the Securities Act of 1933 (the "Securities Act") [15 U.S.C. § 77t(b)] and Section 21(d) of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. § 78u(d)], seeking to permanently restrain and enjoin the Defendants from engaging in the acts and practices alleged herein.

8. The Court has jurisdiction over this action under Sections 20(d) and 22(a) of the Securities Act [15 U.S.C. §§ 77t(d) and 77v(a)] and Sections 21(d), 21(e), and 27 of the Exchange Act [15 U.S.C. §§ 78u(d), 78u(e), and 78aa].

9. Venue is proper because the Southern District of Texas is where: (a) Defendant

Conn's maintains its principal place of business; (b) Defendant Poppe resides; and (c) a substantial part of the acts, omissions, transactions, practices, and courses of business giving rise to the claims occurred.

10. The Defendants, directly and indirectly, made use of the mails or of the means and instrumentalities of interstate commerce in connection with the acts, omissions, transactions, practices, and courses of business described in this complaint.

DEFENDANTS

11. Defendant Conn's is a Delaware corporation headquartered in The Woodlands, Texas. Conn's is a specialty retailer that offers consumer goods and credit financing, primarily to credit-constrained consumers. Conn's common stock is registered under Section 12(b) of the Exchange Act and trades on the NASDAQ under the symbol CONN. Consequently, Conn's offered and sold securities using means and instrumentalities of interstate commerce during the Relevant Period. Conn's files periodic reports, including Forms 10-K, 10-Q, and 8-K, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

12. Defendant Poppe, a resident of Houston, Texas, was a Conn's employee from September 2004 through May 2017. He was its Controller, Assistant CFO, and Treasurer from September 2004 through February 2008, its CFO from February 2008 through April 2012, and its COO from April 2012 through May 2017. He is a CPA licensed in Texas.

STATEMENT OF FACTS

I. BACKGROUND

13. Conn's has two reportable operating segments: retail and credit. The consumer credit programs offered through the credit segment are integral to Conn's business model because Conn's core customers usually do not have cash or financing available to purchase its

products. During the Relevant Period, up to 80 percent of Conn's retail sales were financed with "YE$ MONEY"—an internal credit program offered by Conn's.

14. During the Relevant Period, Conn's reported that the average total outstanding balance in its credit portfolio nearly doubled from $647 million to $1.1 billion. Because the majority of Conn's revenues are financed in-house, the ability to collect those debts is a key driver for the company's overall business performance. For the same reason, Conn's allowance for doubtful accounts was materially important to investors in evaluating Conn's financial health.

II. CONN'S CONSISTENTLY UNDERESTIMATED ITS ALLOWANCE FOR DOUBTFUL ACCOUNTS

15. Throughout the Relevant Period, the Defendants consistently underestimated Conn's allowance for doubtful accounts, which is a reserve for customer account receivables that Conn's expects to charge-off over the next twelve months. They did this by allowing management's subjective bias to influence Conn's roll rate selection, resulting in an insufficient allowance during a period of increasing credit portfolio risk. It further resulted in inaccurate financial statements, which understated Conn's allowance for doubtful accounts and overstated Conn's income. Conn's and its management at the time, including Poppe, acted negligently in failing to correct Conn's reserve methodology—even as actual write offs exceeded the reserves for 14 straight quarters.

a. Conn's Included Undue Management Bias in Its Allowance for Doubtful Account Calculation.

16. Generally Accepted Accounting Principles ("GAAP") required Conn's to identify impaired receivables and to measure and disclose the amount of the impairment associated with such receivables. *See generally* ASC 310-10-35. GAAP also required Conn's to estimate and

accrue for loss contingencies if it was "probable that an asset has been impaired" and the amount of the loss can be reasonably estimated. ASC 450-20-25-2.

17. Conn's allowance for doubtful accounts has two primary components: (i) troubled debt restructuring ("TDR"), which Conn's defines to include all accounts for which payment terms have been extended ("re-aged") over ninety days and all accounts that are refinanced or in bankruptcy; and (ii) non-TDR. Throughout the Relevant Period, Conn's accrual for non-TDR accounts was calculated using a complex roll rate model that was highly subjective and influenced by management bias. As a result, Conn's failed to reasonably measure and disclose the amount of impaired receivables on its books and records as required by GAAP.

18. Throughout the Relevant Period, to calculate its non-TDR reserve, Conn's segmented its portfolio by months re-aged and days delinquent, and then applied a roll rate to each segment. In general, the longer an account is past due and the more it has been re-aged, the higher the likelihood that it will be uncollectible—and therefore, the higher the roll rate. Higher roll rates result in a higher allowance for doubtful accounts, while lower roll rates drive the allowance down.

19. Conn's roll rates were not derived from historical averages or any other calculated adjustments to recent actual roll rates. Instead, Conn's roll rates were hard-coded plugs. Conn's policy was to consider historical trends in setting the future roll rate, but, in practice, the plugs reflected significant—almost exclusively overly optimistic—adjustments to recent and historical actual roll rates. These adjustments ignored historical experience and current trends.

20. As CFO, Poppe helped create the roll rate model. When he became COO, he trained the finance team on how to operate the model and retained control over the process as a member of the management team. Throughout the Relevant Period, Poppe reviewed and

commented on draft roll rate models, recommended adjustments to roll rates based on his operational and strategic insights, and participated in quarterly meetings where the roll rates were finalized.

21. Conn's failed to establish internal controls sufficient to ensure that its allowance for doubtful accounts was reasonable. For example, there were no minutes or notes of the quarterly meetings, roll rate modifications were based primarily on subjective and unreasonably optimistic assessments of current and future operations, the adjustments were not tied to any calculations, and insufficient documentation was kept to reflect or explain the rationale behind the specific changes.

22. Conn's actual charge-offs were consistently higher than projected/reserved charge-offs for 14 consecutive quarters, including every quarter in the Relevant Period. And, as indicated in the annual summary below, the variances grew increasingly large throughout the Relevant Period.

(in thousands)	**FY2013**	**FY2014**	**FY2015**
Net Charge-Offs	$53,276	$69,430	$120,112
Prior Year-End Allowance	$49,904	$43,911	$71,801
Difference	$(3,372)	$(25,519)	$(48,311)

23. The roll rates used by Conn's were unreasonable because of the large, increasing, and consistent variances between actual and projected charge-offs and between actual and projected roll rates. Had Conn's calculated its allowance for doubtful accounts using average historical roll rates, its reserve would have been materially higher – approximately 20 to 30 percent higher throughout the Relevant Period. Despite this, the Defendants continued to use the flawed methodology to determine Conn's subjective loan loss estimates, resulting in the public dissemination of inaccurate financial information.

b. Conn's Roll Rate Plugs Were Not Reasonable In Light of Increasing Risks in its Credit Portfolio.

24. As Conn's and its management team at the time, including Poppe, knew or should have known, the unduly optimistic plugs used in the roll rate model were not reasonable in light of the increased risks in Conn's credit portfolio. During the Relevant Period, Conn's portfolio base shifted towards lower credit score customers and delinquency rates increased. Conn's was also experiencing increasing percentages of new customers, especially those in new markets. As the Defendants knew or should have known, these new customers generally presented more risk since Conn's did not have a record of their credit-worthiness.

25. As indicated in the chart below, during the Relevant Period, Conn's reported an increase in both the amount and percentage of accounts 60+ days past due, which it admits is the leading indicator of potential charge-offs.

Credit Portfolio Data	**FY13**	**FY14**	**FY15**
Account balances 60+ days past due *(in thousands)*	$52,839	$94,403	$133,087
% of balances 60+ days past due to total outstanding balance	7.1%	8.8%	9.7%

26. In addition, starting in the fourth quarter of fiscal 2013, Conn's began loosening its underwriting standards to allow individuals with lower credit scores to obtain credit—particularly in new stores, which should have led management to use less optimistic roll rate projections. As Conn's advised investors and analysts on its quarterly earnings calls not to expect any increase in credit portfolio risk because of these lower underwriting standards, the company reported a 17-point decline in the weighted average origination credit score of sales financed. This publicly-reported metric, however, did not give investors full visibility into the changing composition of the portfolio, which was skewing more towards high-risk customers. For example, the percentage of originations to customers with credit scores below 550 grew from

approximately two percent at the beginning of the Relevant Period to a high of nearly 16 percent in fiscal 2014. During the same period, Conn's more than doubled its lending to customers with no credit score/history. It did not, however, inform investors that these riskier customers were not factored into its weighted average credit scores.

27. Finally, internal Conn's records and public SEC filings reflect that the percentage of new customers in the portfolio doubled from 25 percent at the end of fiscal 2013 to nearly 50 percent the following year. This significantly increased the risk in the portfolio because, as Conn's has acknowledged, new customers who do not have loyalty to Conn's have higher rates of delinquency. During the Relevant Period, Conn's was rapidly expanding, not just into new store locations, but into entirely new geographical markets where it had few, if any, loyal customers.

28. In light of higher delinquency rates and a riskier, more difficult to collect credit portfolio, it was not reasonable for Conn's to decrease the roll rates it plugged into the model.

c. Conn's Changed the Roll Rate Model Methodology in FY2015.

29. In the second quarter of fiscal 2015, Conn's finally started to build up its allowance for doubtful accounts. The roll rates used that quarter were less optimistic and aggressive than they had been in previous quarters, resulting in a higher required reserve. In a September 2, 2014 press release for its second quarter of fiscal 2015, Conn's disclosed, among other things, an operating loss for its credit segment and slashed its fiscal 2015 guidance, which it attributed to "the impact of higher expected provision for bad debts." The same day Conn's stock price dropped 30 percent.

30. In the third quarter of fiscal 2015, Conn's completed its corrections to the allowance for doubtful accounts by removing all subjective adjustments from the roll rate model

and instead calculated roll rates based on a two-year same-month historical average. The change in methodology resulted in an immediate $20 million increase to the reserve, and the higher provision for bad debt drove a $0.08 per share earnings loss for the quarter. In a December 9, 2014 earnings press release, the company disclosed, among other things, that its "credit operations forecasting had not been acceptably accurate," and announced the creation of the Credit Risk and Compliance Committee of the Board of Directors. Conn's stock price dropped 41 percent the same day.

FIRST CLAIM FOR RELIEF
Violations of Securities Act Section 17(a)(3) Against All Defendants

31. Plaintiff SEC re-alleges and incorporates paragraphs 1 through 30 of this Complaint by reference as if set forth verbatim in this Claim.

32. By engaging in the acts and conduct alleged herein, Defendants directly or indirectly, singly or in concert with others, in the offer and sale of securities, by use of the means and instruments of transportation and communication in interstate commerce or by use of the mails, have engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit.

33. Defendants were negligent in their conduct and in the untrue and misleading statements alleged herein. *See Aaron v. SEC*, 446 U.S. 680, 697 (1980) (holding that claims under Section 17(a)(3) do not require a showing of *scienter*).

34. By reason of the foregoing, Defendants have violated and, unless enjoined, will continue to violate Section 17(a)(3) of the Securities Act [15 U.S.C. § 77q(a)(3)].

SECOND CLAIM
Violations of Exchange Act Section 13(a)
and Exchange Act Rules 12b-20, 13a-1, 13a-11, and 13a-13 Against Conn's

35. Plaintiff SEC re-alleges and incorporates paragraphs 1 through 30 of this

Complaint by reference as if set forth verbatim in this Claim.

36. By engaging in the acts and conduct alleged herein, Conn's directly or indirectly, singly or in concert with others, has filed with the Commission reports required to be filed with the Commission pursuant to Section 13(a) of the Exchange Act and the rules and regulations promulgated thereunder that: (a) contain untrue statements of material fact; (b) fail to include, in addition to the information required to be stated in such report, such further material information as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading; or (c) fail to disclose any information required to be disclosed therein.

37. By reason of the foregoing, Conn's has violated, and unless restrained and enjoined will continue to violate, Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13].

THIRD CLAIM
Violations of Exchange Act Section 13(b)(2)(A) Against Conn's

38. Plaintiff SEC re-alleges and incorporates paragraphs 1 through 30 of this Complaint by reference as if set forth verbatim in this Claim.

39. By engaging in the acts and conduct alleged herein, Conn's directly or indirectly, singly or in concert with others, has failed to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company.

40. By reason of the foregoing, Conn's has violated, and unless restrained and enjoined will continue to violate, Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)].

FOURTH CLAIM
Violations of Exchange Act Section 13(b)(2)(B) Against Conn's

41. Plaintiff SEC re-alleges and incorporates paragraphs 1 through 30 of this Complaint by reference as if set forth verbatim in this Claim.

42. By engaging in the acts and conduct alleged herein, Conn's directly or indirectly, singly or in concert with others, has failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (a) transactions are executed in accordance with management's general or specific authorization; (b) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets; (c) access to assets is permitted only in accordance with management's general or specific authorization; and (d) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

43. By reason of the foregoing, Conn's has violated, and unless restrained and enjoined will continue to violate, Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)].

PRAYER FOR RELIEF

WHEREFORE, the SEC respectfully requests that the Court enter a judgment:

I.

Permanently enjoining Conn's from future violations of Section 17(a)(3) of the Securities Act [15 U.S.C. §§ 77q(a)(3)], and Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A), and 78m(b)(2)(B)] and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13].

II.

Permanently enjoining Poppe from future violations of Section 17(a)(3) of the Securities Act [15 U.S.C. §§ 77q(a)(3)].

III.

Imposing a civil penalty against Conn's pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] and Section 21(d)(3) of the Exchange Act [15 U.S.C. § 78u(d)(3)] for violations of the federal securities laws as alleged herein;

IV.

Imposing a civil penalty against Poppe pursuant to Section 20(d) of the Securities Act [15 U.S.C. § 77t(d)] for violations of the federal securities laws as alleged herein;

V.

Imposing such other and further relief as the SEC may show itself entitled.

Dated: July 15, 2019

Respectfully submitted,

s/Chris A. Davis
CHRIS A. DAVIS
Texas Bar No. 24050483
S. D. Texas Bar No. 3030528
United States Securities and Exchange Commission
Fort Worth Regional Office
801 Cherry Street, Suite 1900
Fort Worth, Texas 76102
(817) 900-2638 (phone)
(817) 978-4927 (facsimile)
DavisCa@SEC.gov

ATTORNEY FOR PLAINTIFF