



## Podcast Transcription Session 24: Jonathan Morris

**Peter Renton:** Welcome to the Lend Academy Podcast, session number 24. This is your host, Peter Renton, founder of Lend Academy.

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**Peter:** Today on the show, I am delighted to welcome Jonathan Morris. Now, Jonathan is a little bit different to other guests that I've had. In fact, I've never had anyone quite like him because he comes from the other side of peer-to-peer lending, shall we say, he comes from the bank side. Yes, he is a banker; he is the President of BMC Bancshares which is a holding company that owns Titan Bank. They are a small bank based in Texas. Now, for those of you that have been following closely for a while may recognize the name Titan Bank. They were one of the first banks to invest on the loans on Lending Club platform. They made a big announcement back in June of 2013; Lending Club did, with two banks that had decided to invest in Lending Club loans. One of those banks was Titan Bank so Jonathan has been investing for a while now. I thought it will be very interesting to get his perspective on things. Hope you enjoy the show.

**Peter:** Welcome to the podcast, Jonathan.

**Jonathan Morris:** Thank you very much, Peter.

**Peter:** Let's start off and tell the listeners a little bit of background about yourself and how you came to own a Texas bank.

**Jonathan:** Well, we have another company in the space which is also a financial services company called BMC Capital which is an affiliate of the bank. So we had been working with a number of banks around the country helping to originate and sell hundreds and millions of dollars of small balance commercial real estate loans. Five or six years ago, when the banking sector was blowing up there was a good opportunity to buy a small national bank in Texas and we were fortunate enough to acquire that and that's called Titan Bank which we own now.

**Peter:** Okay, then what was your background before you...I mean, you got into financial services, I know you've also been in the tech business, what's...can you give people a little bit of..... more color about your history?

**Jonathan:** Sure, before that, I actually got to have some fun before we bought a bank. (laughs) When I started off my career, I had started several tech companies that were located in Asia. I actually lived in Jakarta, Indonesia for about five years. One of them even sold software to banks. Probably starting about ten years ago, I started to focus more on financial services and getting into this lending space. Ever since then we've been working fairly closely with banks or running around.



**Peter:** Okay, so then describe, if you would, a little bit about Titan Bank; how big is it, what sort of loans do you do right now, what's the bank like?

**Jonathan:** Sure, Titan Bank...it's about a 107-year old national bank, we're based in Texas, we do loans around the country for all our business lines, but it's a very small bank. It's what you would think of as a traditional community bank in all respects and customers in Texas can walk into our branches. We're a small bank, we don't have very many branches, but they walk in and have all the services of a typical bank except for the fact that we actually know their name unlike a lot of the larger banks.

**Peter:** Right.

**Jonathan:** On the lending side, what we primarily do is small business loans for small merchants so we make loans typically used in the SBA program which might range from half a million dollars to \$5M, most typically.

**Peter:** Okay, so how many branches do you have in Texas? Are the branches all in Texas?

**Jonathan:** It's a two-branch bank and we've been watching carefully and it just seems difficult to build branches these days because ultimately, it's unclear if you're ever going to need more than one branch and a really good mold on the Internet side, the way the world is going.

**Peter:** Exactly, exactly. It's probably a smart move not to have lots of real estate.

**Jonathan:** One of our challenges in that is that ultimately, we don't have that many consumers coming in to the branches to ask for loans so peer-to-peer was such a natural fit for us.

**Peter:** Okay, so let's just start to get into that. When did you first become aware or how long have you been following the space?

**Jonathan:** I don't know exactly when I became aware of it, but I think fairly on when Prosper had initiated, let's say, its 1.0 model, their initial model they were working on. I started following at that point in time more as a curiosity. I wasn't into the market on their head that time, but I would check in from time to time and really continued to watch it ever since until we got involved with the model ourselves.

**Peter:** Okay, so let's go back to that. I mean, I remember it was June of 2013... announced at LendIt where you had...Lending Club basically announced the partnership with you, with your bank and another community bank. Can you give us a little bit of background about that deal? I mean, how long had you been talking with Lending Club? Did you go to them? Did they come to you? How did the deal get put together?



**Jonathan:** You know, if I recollect, we had been talking to several of the platforms for several years before that deal was announced and a lot of what we needed to do was kind of wait for platforms to evolve to be able to support a national bank as an investor in the loans. There are several things that we do as a bank and several requirements that we have that may be different from a standard individual or even some of the other institutional investors and we just needed to wait until the platforms matured to support that. Obviously, we felt Lending Club did in 2013 and we felt comfortable going forward with the partnership.

**Peter:** Okay, so what makes peer-to-peer lending so attractive for a bank like yours?

**Jonathan:** For us it's two things. The first is that ultimately it's difficult for a bank, especially a small community bank like ourselves, to do very small loans in the \$5,000 to \$20,000 range let's say that are not secured by any assets because you need a lot of technology and a lot of data to be able to make sense, whether or not that loan makes sense and what the rate should be. So we were able to effectively lease all that underwriting technology from the peer-to-peer providers. We'll ultimately make our own credit decisions. It would be so expensive for us to have to build the systems that these guys use to gather all that information for us to make that decision that we would never be able to do it to the same level ourselves.

The second thing is that we're not marketing experts. We have branches, but we have the home people come into these branches and the ability to get access to so many more consumers that we can help and provide loans to through these platforms versus what we have today was fantastic for us so it turned out to be a great opportunity on both dimensions.

**Peter:** Okay, so you started with Lending Club basically 15 months ago thereabouts; what kinds of borrowers are you investing in? Are you doing a range of all the different loan grades or are you focusing just on the lower risk and where are you going with that?

**Jonathan:** We're a bank, obviously, and as part of that we tend to be risk averse in general. We take responsibility seriously because we're working with government insured funds. We will tend to focus on the lowest risk rates of the peer-to-peer platforms and either... typically borrowers were also paying lowest interest rates, but they have the most prudent history. We tend to be quite different from a lot of the institutional investors like hedge funds and private equity funds who are completely focused on the high risk/high yield loan opportunities. I think that banks are fairly useful for the peer-to-peer platforms because we can really fill in for the areas that a lot of institutional investors otherwise can't afford to buy loans in.

**Peter:** Right, right, that makes sense. So are you buying whole loans only or are you buying whole and fractional, what are you doing?

**Jonathan:** We can only buy whole loans.

**Peter:** Okay



**Jonathan:** My interpretation of the banking regulations means that's just a requirement for us.

**Peter:** Right, right, okay. You've been investing now for a while, are you happy with everything? Obviously, you've had some returns come in; you've probably even had the occasional default. I imagine it with the lowest risk ones, I mean, are you happy with the way things are going?

**Jonathan:** Oh, we've been very happy and you know, we bought more than a thousand loans and while we've certainly had some defaults, similar to our offline portfolios, the returns most of all have been virtually exactly what we've predicted and that makes up feel pretty good and we're certainly continuing to have our presence in the space. We're continuing to reinvest proceeds and even slowly kind of increase our activity in the peer-to-peer space.

**Peter:** Right, okay, great. Are you deploying your capital and also you're using whole loans only, you're using the API, I mean, how do you actually, physically buy in the loans.

**Jonathan:** Most of our buy-in has been through the API. We operate around computer systems, our own servers, and that's been another banking requirement that we can control the technology base that we're operating off of, but one thing as a bank, I should clarify, is it's been very important that we don't just trust the platform's own credit positioning. We need to use our own credit models and our own credit underwriting and that's a significant requirement for ourselves. What we'll ultimately do is look at all the variables that will come off the API, put it through our own deaccessioning models and make a selection loan by loan if it makes sense to the bank's credit policies.

**Peter:** Okay, so did you develop this from scratch? Did you take your own expertise in underwriting? You see, you don't really do consumer loans, you're doing mainly SBA loans...obviously, you're underwriting on the performance, but is that....I'm just trying to work out how you developed your own credit model.

**Jonathan:** No, and on top of that I'm not a data scientist, I don't have a Ph.D. in statistics. (laughs) Fortunately, I work with somebody who's very, very talented that does. His name is Bryce Mason and he has been exceptional in helping us write the program.

**Peter:** Bryce has been on the podcast before. He's the peer-to-peer picks guy so that's great you're working with him. So then have you....you started off in Lending Club 15 months ago, are you doing anything else? Are you expanding to other platforms? What have you been doing?

**Jonathan:** We've started off with Lending Club; we expanded and have also acquired some loans from Prosper. For now, those are the only two platforms that we've acquired any loans from and ultimately, what we look at is what's the maturity of the platform, what's the maturity of the data that they have, is there a meaningful enough data set that we can actually predict our returns or not. The other thing that we're looking at is what are internal policies, their policies and procedures and how good is their documentation. If we don't operate...I should put it this way, if they don't operate to a bank standard, we can't partner with them. So it's ultimately when those platforms



give us the ability to partner with them like they were another bank that we're able to interact and acquire loans from them.

**Peter:** Okay, so it's good to know that both platforms are up to banking standards, I guess. So then are you .....you obviously are doing your small business lending, are you interested in also the small business platforms that are sprouting up online or is that...are you really going to stick with the consumer loans?

**Jonathan:** I think for now we've been most comfortable with the consumer loans. That being said, we're certainly in discussions with a number of the small business platforms. I think they've been interested in working with us not only because we're a bank, but that's the space that we're typically in so we're watching to see how that space evolves for now and we're going to make our decisions later on.

**Peter:** So how big could this get for you? I mean, you're a reasonably small bank, you've made a thousand whole loans, are you thinking this is going to be 50% of your business as far as making loans. I mean, what are your thoughts there?

**Jonathan:** It's a great question. One of the things that get looked at for any bank, regardless of the size is what's called concentration of credit and one of the concentrations right now that we look at is peer-to-peer lending itself. It's difficult for any bank to get above let's say 10 or 15% of its total loans going into any one sector so we're trying to limit it at that size. We've steadily been increasing and the size of our bank steadily increases, but, unfortunately, there's certain limits in the regulated world. That just happens to be one of them.

**Peter:** Right, that makes sense. We've talked a little bit about the banks regulations that you have to work with these platforms; did you approach the regulators about this? I mean, you are the first bank to come on to these platforms, how did you get comfortable with that? Did you seek approval with the FDIC or whoever or any other regulatory body when you made this decision?

**Jonathan:** Sure, it's another great question. We're regulated by the OCC which is the Office of the Controller of the Currency. The OCC regulates all national banks so it could be from Titan Bank on the small side to Citibank or Wells Fargo on the large side. Every bank has its own approach towards the regulators. Our approach has been to be kind of very open, upfront, talk to them in advance on anything significant that we're going to do. So we started talking to the regulators, our local office several months before doing anything. With the peer-to-peer side, we communicated with them, we showed them everything that we're doing, the types of models that we're running and part of that was just to get the regulators comfortable and explain to them what we're doing. It's a fair bit of work on any loan program with the regulators and frankly, it's a fair bit of work for them because they have a difficult job of making sure banks don't do stupid things with the government's money. Effectively, we've both seen the ramifications of what happens when they do, but, I think they've been reasonable to work with on these programs.



**Peter:** When you first went to them did they think you were crazy, did they know what the hell you were talking about even? I mean, I imagine you had to through a learning process with them.

**Jonathan:** Actually, the first thing I should say is for the regulators we work with. Everybody who's listening that doesn't run a bank which will be most of the listeners (laughs) may have the impression on bank regulators ...the guys that we worked with are smart. The first thing I said is I'm thinking about doing something with Lending Club and they said why not Prosper (laughs) and it turns out some of them had been playing the sectors themselves.

**Peter:** Interesting.

**Jonathan:** ...and were very, very familiar with what it was and a lot of the questions were more technical in nature as opposed to is this sane or is this not sane. It was more how do you comply with all the banking regs and the banking code with a platform like this. Ultimately for us, it comes down to what are the policies that are in place that platforms have or do the policies are in place that the bank they originate through has in place and a lot of work that we need to do ongoing as a bank to go through...how do we test our models, how do we back test our models to see that they're working. How do we go through each individual note to make sure that note is a real and valid note and wasn't just made up by one of the platforms from scratch in a scheme. On top of that, reviewing subject data and verifications and all kinds of other information that's required of a bank that fortunately the institutional investors probably doesn't require of them, the outside parties. Other banks have comments and said, hey, is this a good idea for us and I said, well, it depends. It could be, but you better be prepared to put a lot of work into the programs because otherwise you're probably not going to do it in a way that's going to allow you to do it over the long term.

**Peter:** Right, that's a good point because I imagine too, you're talking with your local OCC people. I imagine a bank in California is going to have to deal with completely different people who may not have the level of education. Maybe you got lucky with the people that you're in.

**Jonathan:** Well, I'm lucky, I'm in Texas so, of course, we're better than everybody else (laughs). I'm kidding. I joke about that, but I'm originally from Boston, but that being said, I think it may be less about the platforms themselves and more about how an individual bank is carrying out the program. You have to really understand what you're buying. It can't be I've said it and forget it and the bank deploying millions and millions of dollars into these programs and not having a fundamental understanding of what are you buying, have you verified that it's real and do you really have a realistic way to predict what your returns are going to be, both in a good scenario and a negative scenario that market takes a nosedive, the economy takes a nosedive like it did five or six years ago. Those are all reasonable requests of the regulators and it's certainly reasonable to request that banks are going to comply with that and are moving into some sort of new technology and a new sector. Let's face it, banks are that good at new things and they're certainly not that good at new technology



so I think some of the banks are going to be able to do it and most will have difficulty doing it the right way.

**Peter:** Right, yeah that makes sense. I just want to go back to when you started up with Lending Club. When you...obviously for them it was a big deal to get some banks on the platform. They've been talking about disintermediating the banks and here we are now, now we talk about partnering with the banks. Did they have to change much when you went to look at them and you obviously had lots of talks in advance of signing a deal, did they have to change much of their processes or they were so compliant that you went, okay, this is great, we just slot right in here and just really making sure it was comfortable. What was that like?

**Jonathan:** It kind of was a shock at how good Lending Club was when we went there; the level of policies that they have, the quality of people, some of the verification systems that we were able to see on site really surprised me in a good way. I think there was then.... and over time as things have evolved, a few things have had been let's say tweaked, but they were running their programs better than probably 90% of the banks do themselves. It worked fairly well for us in that respect.

**Peter:** That's really good to hear, actually, that's good to hear because we don't really know how it compares to the banks so it's good to hear a banker saying that. So then has it ever crossed your mind....I know you're a relatively small bank, but has it ever crossed your mind to cut out Lending Club and Prosper and start your own peer-to-peer lending operation?

**Jonathan:** On the consumer side, those platforms are so strong. The technology investment they've put in has been so much, there's just no feasible way that we could cost effectively do that even with our low cost of capital. I don't think we're in a position to ever be able to do it better than they do it. We can't put in the technology investment and they're so far along in the data set that it would be difficult, I think, for very many banks to compete with them except for the large ones out there.

On the small business side, it's certainly a market that we've been looking at. Part of our questions are is that we have a great program where we work with the SBA and in some phenomenal sort of business programs for small merchants, small businesses we're looking at opportunities to take advantage of that via technology, whether it's a traditional peer-to-peer or something that looks a little bit different.

**Peter:** Right, okay, so let's talk about the big banks for a second because this is something that comes up in conversations many, many times, I find, where people say, well, you kind of look at other industries that have been really overturned and completely impacted by technology. There's many like the travel industry, the music industry, the newspaper business, there are so many industries and banking today, for the most part, is still the same as it was 50 years ago, the core business. What do you think the impact like on the big banks and do you ever see one of the larger banks really going head to head and take a really aggressive stance in this business and take on



Lending Club or Prosper or anything like that? I mean, what is stopping the big banks from really doing that?

**Jonathan:** We're kind of curious ourselves to see how it plays out. Now as the guy that hates big banks would what....I have enjoyed watching is the fact that almost all the business that Lending Club and Prosper are taking at least are coming from large banks and typically.....as you know, Peter, customers that have high credit card balances and they're paying just this these outlandish rates and fees to the banks and they're able to refinance that into an amortizing loan that they can eventually pay off. We think the peer-to-peer platforms have been in the customer's best interest and that's been one of the reasons why we've been comfortable in playing in that space. I think, right now, it's kind of a very, very small pin prick for the banks when you look at...Wells, Citi, and Chase just how much debt they have on their books and even that is just a tiny amount for it, but it's growing over time and we know it's coming up on their radar screens right now and I guess our question here is are they going to try to buyout the platforms and effectively take them over and co-op them or do they start their own. I think something's going to have to happen eventually as the platforms continue to grow. I'd like to be able to watch how the big boys duke it out.

**Peter:** Right, right, well, you talked to Renaud or the Prosper guys, they seem to be convinced that a bank is not going to really be a good fit. Look at the multiples of banks

and look at the multiples of Lending Club is shooting for their IPO; it's going to be a tough sell. I will be interested to see...eventually, it's going to be more than pin prick, that's the thing. If they keep doubling every year, they're going to do somewhere around \$5 Billion this year in loans, you keep doubling every year, it doesn't take long to start to be a lot more than a pin prick.

**Jonathan:** Sure.

**Peter:** That is the question so you're going to follow along, I guess, like all of these....so what's the future for your bank, for Titan Bank? Do you have a growth plan in place? Obviously, Lending Club and Prosper are only going to be a certain portion of your business, where are you taking your bank?

**Jonathan:** Well, we focus on every day, first and foremost, is going out around the country and we have sales offices around the country and funding small companies with SBA loans. A typical customer might range from a doctor or dentist to a CPA to somebody that wants to build new car wash and that's what we focus on expanding the most ourselves. But as part of that, it's been awesome to get the access on the consumer loans that we've had so much difficulty getting, otherwise, I think as part of that we hope to continue growing our bank, but also continue increasing the amount of loans that we have in the peer-to-peer sector as long as the sector keeps performing strong like it has been for us in the past.

**Peter:** Well, on that note, I have to let you go. It's been a fascinating discussion, Jonathan. I really appreciate your coming on the show.





**Jonathan:** Thank you so much.

**Peter:** Okay, see you later. Well, I thought that was just fascinating. The money quote for me and the key takeaway, I think, is that when he said about....about two thirds of the way through Jonathan said that Lending Club systems are really better than 90% of the banks out there and that when he went to Lending Club he was pleasantly surprised and really to get a bank on their platform was really not that big a deal for him...Lending Club's perspectives so that was really good to see. Also interesting to see the hoops that banks have to go through and the opinions of the regulators and the attitudes and that sort of thing. I think banks are going to be a part of this industry, they are going to be a bigger part, I expect, as we go forward. I think having some perspective here was very useful.

On that note, I will sign off and hope you enjoyed the show. I'll catch you next time. Thanks. Bye.

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