PODCAST TRANSCRIPTION SESSION NO. 106-TIM RANNEY

Welcome to the Lend Academy Podcast Episode No. 106. This is your host, Peter Renton, Co-Founder of LendIt and Founder of Lend Academy.

(music)

Peter Renton: Today on the show, I'm delighted to welcome Tim Ranney, he is the President and Founder of Clarity Services. Now, Clarity is an interesting company and Tim has done something that few people have ever attempted, and that is to create a credit bureau from scratch. Now it is not directly competing with the big three, his focus is on subprime consumers. So we talk about the story of how he was able to get a credit bureau off the ground from scratch, we talk about the product offerings. We also talk about the subprime consumer, who this person is; we also spend quite a bit of time exploring fraud rings, what they are and how they can be prevented and we also talk about the subprime consumer, what is the state of the subprime consumer today and Tim provides some warnings for people who are really underwriting loans today. It was a fascinating episode, I hope you enjoy the show.

Welcome to the podcast, Tim!

Tim Ranney: Thank you.

Peter: So why don't we get started by giving the listeners a little bit of background about yourself. I know you started Clarity Services many years ago now, but tell us a little bit about the arch of your career before that point.

Tim: Well I started Clarity in the summer of 2008, but we'll back up before that. Going clear back into the 80's and 90's, I ran a company/owned a company and what we did was large database design. I guess we were doing big data before anybody called it big data.

Peter: Right.

Tim: Among other things, we did large database systems and distributed database systems for Wall Street trading firms. This was back in the 80's and 90's and we actually had to invent some of the technology to get those kinds of systems built back then and by today's standards they were pretty primitive, but back then they were really something.

And in the late 90's, I was a senior executive at Network Solutions and I ran a division of Network Solutions that was responsible for...the division was referred to as Internet Engineering and the fun fact in that is although this activity happened at Network Solutions before I was there, but the division that I managed in fact was the group of guys that did the original engineering for what was the original internet put up by DARPA and the National Science Foundation. So contrary to what a lot of people believe and think, Al Gore did not invent the internet, (Peter laughs) it was some of the guys that worked for me.

Peter: Right, okay, glad we're clear on that.

Tim: But it wasn't me that invented it, it was a bunch of guys that worked for me and they were there long before I was.

Peter: Right, right.

Tim: I got into the credit bureau, the subprime credit bureau business in 2005. I got involved with a payday loan credit bureau at the time that was kind of moving fast for a number of years in the subprime credit bureau space called CL Verify and I was Chief Operating Officer for CL Verify for several years and they were one of the significant players in the space during the mid 2000's.

I left CL Verify in 2008, and didn't leave CL Verify to start Clarity. I just left CL Verify to kind of take a break and while I was on my break a number of people started approaching me and essentially said...paid me I guess what I guess would be the ultimate compliment, they said that I understood subprime and online credit and underwriting better than anybody in the industry and they were suggesting that I start a bureau. So we started a new credit bureau from scratch in the summer of 2008 with 2,000 ft. of office space and a clean sheet of paper and that is what has become Clarity Services today.

Peter: Wow, I mean how do you start a credit bureau, how do you even begin because you've got to basically, it's a data business more than anything so how did you get going?

Tim: Well, you know, it's chicken and the egg, yeah, a credit bureau with no data, nobody is going to buy a report…

Peter: Right.

Tim: ...and a credit bureau not selling any reports is not amassing data very fast, but we started in the summer of 2008 and started building products and infrastructure and established some data partners so there would be some data in the reports in the early days and quite honestly went out and made the business and analytics case to a handful of large players....what were the large players in the online space at the time. They were impressed with what they saw and several of them took the leap of faith and came on with us early on and those handful of lenders that took the leap of faith early on essentially provided the data and that was the data critical mass that we needed to really get Clarity started. Once they came on, the rest was kind of history.

Peter: Okay, that's great. So then you call yourself the real-time credit bureau, it's there on your homepage. I guess, why don't you explain what Clarity does, what services you actually offer?

Tim: Well I'll distinguish us from what get commonly referred to as the "Big Three" credit bureaus. The Big Three are Equifax, Experian and TransUnion and they've been around for a million years (Peter laughs), maybe not a million years, but they've been around longer than we

have. They've been around, their systems, their architecture has been around a very long time and if you go and apply for a credit card, a car loan, a mortgage, whatever the case may be, they're going to sell the reports on that and they capture data on predominantly prime consumers. But there's a big chunk of the population that isn't prime consumers and there's lots and lots and lots of credit transactions that go on in the US every day that don't make it to those three credit bureaus coupled with the fact that the nature of the prime credit business is that there is a lag between when the credit transactions occur and often when they make it on to the credit reports and I know the three big bureaus are working very hard to shorten that lag time.

Let's use an example, let's say I have an American Express card and that Amex card, for the sake of argument, my bill is due…is payable on the 23rd or the 24th of the month every month and let's say hypothetically this month I chose not to pay it. Well you could pull my credit report on the 25th of the month and my Amex card would still show paid as agreed. You could check on the 1st of the following month, you could check on the 15th of the following month and there's the distinct possibility that my Amex card would still show that I'm paid in good standing.

There's time lags in the data that's going into the Big Three credit bureau systems, but we all know in the current age of high technology and high velocity of information...I mean, that lag might as well be a hundred years for the impact that it has on the ability of a financial services organization or financial institution to make a good real-time decision on a consumer because with real-time applications, real-time credit underwriting, real-time decisions, and real-time distribution of funds, you know, a consumer can apply for ten loans in three minutes and get all of the loan proceeds in the following five minutes. So those kinds of time lags in the transmission, in the aggregation, in the communication of credit status information just doesn't work anymore.

The Clarity system is designed to do everything we can to eliminate those time lags on the capture and the transmission of credit information, not just the posting of when a credit report is pulled on a consumer, but when the status changes on credit obligations are posted to the credit reports to eliminate as much of those lag times as possible. So when a financial institution or when a lender needs a report on a consumer they're getting the absolute most current, up to date, up to the minute, up to the second snapshot of the consumer's credit status as is technologically possible.

That's one of the things that Clarity does, we think better than anybody else coupled with the fact that Clarity specializes in capturing all of the credit data that's out in the market space that the Big Three don't capture. So you could go to any one of the big bureaus and you might pull a credit report on a consumer and not get much current information or not get much of any information back and you might come to Clarity and you might find a couple of installment loans or a payday loan or a car loan or a couple of rent-to-own transactions or a variety of other credit transactions that just don't ever make it to one of the traditional bureaus.

So you go to the traditional bureaus, they don't have any information on the consumer; you come to Clarity, we've got all the information that doesn't get reported to the traditional bureaus.

So Clarity is not a replacement nor do we compete with the Big Three bureaus; we're the source of all data that the Big Three bureaus don't have.

Peter: Okay, why don't they have that data, why don't they go and get the same data that you've got?

Tim: Well in some cases the bureaus are trying to do that, but in many cases their systems maybe don't lend themselves very well to it, the traditional bureaus and again, I don't want to spend a lot of time trying to sound expert on their operating and technology and architecture models, but their architecture, their historical architecture was designed around a credit world where credit obligations/credit transactions were engaged in by consumers and there were payments due on a monthly basis.

You know, you get a mortgage and you owe mortgage payment monthly, you owe a car payment monthly, you owe a credit card, you get a monthly bill and you make a monthly payment on it, but in a lot of the newer generation of credit in a lot of cases, payments are often tied to the consumers' payroll cycle rather than monthly billing cycles so consumers pay every other week, twice a month or every week in some cases, a consumer may have a payment obligation that's weekly and to report those obligations to a credit bureau system that is designed to capture and track credit obligations on a monthly payment cycle, a monthly reporting cycle, there is an architectural disconnect that makes it more challenging.

Peter: Yeah, for sure. So then can you explain how you're able to do it...you said up to the minute, up to the second. I mean, are you basically working with all of these lenders, not even lenders, but, you know the people that you say are providing data to you, are all these providers doing….are they connected to you through an API and doing it in real-time, is that how…that must be the only way it's possible, right?

Tim: Probably half of our customers are connected to us with real-time APIs and in those cases a lender makes a payment, the payment gets posted to the lender's loan record and at that moment we're getting a status update that we post through our trade lines real-time and that trade line update then is reflected in any credit report pulled from that moment on by any other lender that comes to Clarity for a report.

We have another group of lenders...probably 30% or 35% of our lenders that quite honestly from a technology standpoint they're not capable of reporting real-time via an API, but they're doing what we would consider the next best step and that is they're reporting in a batch format on a nightly basis. So we're not waiting monthly for those batches, we're getting nightly updates. Again, that still leaves a 24-hour lag, a 24-hour window of a reporting invisibility, but it's far better than a 30-day window of invisibility.

Peter: Right.

Tim: And then we do have a group of lenders that, because of technology or other constraints, we are getting monthly reporting from probably 15% or 20% of our customers.

Peter: Okay, okay, so then I just want to talk a little bit about the consumers that you are reporting on. These are obviously part of the underbanked or unbanked, I'm guessing a lot of these people…are they immigrants, I mean, what is the profile of the people that you have data on?

Tim: Well it's interesting, immigrants…people assume…there is a population, there is a non-Social [no Social Security Number] population in the US, a very large non-Social population in the US and very simply put, they are challenged in gaining access to the credit and financial systems in the US. There are no laws in the US that mandate that a consumer has to have a Social in order to get a bank account or in order to secure credit in the US. However, banks and financial institutions have the regulations around what's referred to as KYC, Know Your Customer that require the lenders and banks to definitively identify the consumer and establish firm identity credentials on the consumer before they can establish credit.

In the US, lots and lots of the identity verification tools are Social based and so in many cases, consumers without a Social are more challenged in finding an institution who have systems in place to do the KYC verification without a Social Security Number and it becomes even more challenging online. A consumer has an easier time walking into a financial institution with a storefront presence and establishing a variety of physical credentials to establish their identity versus without a Social establishing a firm identity online without a Social so it becomes more challenging.

So we probably don't have as many of those non-Social identities in the system as you might think, however, non-bank...it's funny because people throw out a lot of terms, subprime, near-prime, deep subprime, unbanked, underbanked, but in many cases they throw those terms out and then they start talking about those populations without even defining the terms. They assume that everybody else is, just by osmosis, has the same clear definition of those terms as they have.

Peter: Right.

Tim: So, for example, an unbanked or underbanked consumer is not necessarily a subprime consumer and not all subprime consumers are the same. The definition of subprime is not...you could ask any three people in the industry and you get three different definitions of subprime. Our definition of subprime is FICO 600 or below, for example, although I've heard people use FICO 660 as a subprime cut-off as an example. I've talked to some friends at Experian who thought that FICO 600 was deep subprime, but however, for our definition FICO 600 is subprime, that's where we put the stake in the ground.

In the online space, most of the subprime consumers are banked because most of the online credit transactions that we see typically are tied to a bank account for purposes of funding and/or collecting payments so you see more subprime transactions storefront or brick & mortar transactions involving unbanked or underbanked consumers versus you see more subprime

transactions involving bank consumers online and that's a distinction. People when they talk about these populations they tend to not parse them.

Peter: Right.

Tim: You also see the population online being younger than the brick & mortar subprime population. You see the online population, quite honestly, having a lower average net monthly income but a higher discretionary income than the storefront population. So there are a lot of things that you can actually distinguish between the various populations that are using the various different types of credit and the various different credit channels that are available. When you really start to break it down to subpopulations it gets very fascinating.

Peter: Yeah.

Tim: But, unfortunately, for most people that we talk to they tend to talk big picture and they tend to generalize. They tend to view...for example, a lot of people when they say subprime what they're really talking about is low income consumers. And quite honestly, a lot of low income consumers, probably more than 50% of them, their score may be subprime, but that low score bears no reflection upon their ability or willingness to pay a credit obligation. It is more an indication of the fact that they simply choose not to use credit.

Peter: Right.

Tim: And so like I said, most people that talk about these topics that claim to be experts really don't know what they're talking about.

Peter: (laughs) Okay, right. Well I want to move on to fraud because...you gave a presentation at LendIt on fraud rings and I went back and watched it again just a couple of days ago. I'd like you to explain firstly what a fraud ring is and what you guys are doing to prevent fraud from happening.

Tim: Okay, there are several kinds of fraud and we'll talk about the fraud rings first. You watch the LifeLock commercials and you start out, you assume that there's a roomful of people in Nigeria and the lights are turned down and they're busy trying to take advantage of everybody. Fraud rings, my guess is that most of them are more domestic based than they are foreign based and in most cases my guess is they're not large groups of people, they're smaller groups of people, most of them are less sophisticated.

A fraud ring, by virtue of a ring, you might assume that it's lots of people, but it may be just one person perpetrating the ring. The definition of the ring comes about by virtue of the person or people using many, many permutations of the same set of identity elements to create multiple unique identity element combinations to try to get through the screening to get credit.

So somebody who has got a bunch of identity information and they go out with Social number one using Tim Ranney at his home address and then they go out with Social number two using

Tim Ranney at his home address then they go out with Social number three using Tim Ranney at some other address. Then they go out with Social number two using some other name at Tim Ranney's home address. By virtue of the chaining together commonality of discrete data elements spanning these multiple combined identities that are all somehow chained together by data elements connected with degrees of separation, you've got a fraud ring.

In a very lay terminology that's what a fraud ring is and that's what fraud ring identities are all about. It's a matter of where the person behind the fraud ring gets the identity/identities or the identity data elements that they use to construct synthetic identities, that is these manufactured identities, and where they come out the door with them. The manufactured identities that we see and the data elements they get come from lots of places. Again, they don't all come offshore.

We've seen fraud rings where...there was a fraud ring that came locally out of Florida here where somebody was stealing mail out of the mailbox at an RV trailer park, for example. Pretty unsophisticated but it was effective and it was close enough to home that one day I got to looking at this and we tracked this fraud ring and I finally drove over and it's like, oh, this is a trailer park and it was really kind of an interesting revelation.

We saw fraud rings where it was somebody that worked at an assisted living facility and they were stealing information about the identities of the residents in this assisted living facility so it's all sorts of stuff, you know, bank tellers at banks that are stealing. The people that are sometimes perpetrating fraud rings are...they're criminals, they're certainly all criminals, but you know, a fraudster could be the person behind the teller at a counter in a bank for all you know and they could be using that position to gather the information. They're not all buying the information off the dark web, for example.

Peter: Right.

Tim: But wherever they get the information, how they mash it together and what they try to go do with it is all the same. What the fraudster in the online space will tend to do is that they'll hit a lender and if they find a weakness in the fraud screening technology of a particular lender, they will hit that lender again and again and again until they can't hit that lender anymore and then they will move on to another lender.

It's not like they'll construct an identity, go to lender A, find that they can get a loan and then go to lender B, C, and D immediately. They'll go to Lender A, they'll find that their fabricated identity worked so they'll go back to lender A with another fabricated identity and another fabricated identity and another fabricated identity and then they'll move on to lender B because it's easier that way.

Peter: Right.

Tim: So something in the industry that organizations like ours use and there are a lot of organizations that do it that's referred to as link analysis and that is, you're looking at each data element on an inbound application and you're looking for [inaudible] not only you're looking at all

the data elements together to see if all of these elements should fit together.

A simple example of that is I've got a consumer that's living in Fargo, North Dakota but their phone number is a Boca Raton, Florida phone number, what sense does that make? Or, they're using a bank account that only has branches in Los Angeles, what sense does that make? So you start by looking at the identities to say, do all of the components of the identity seem to make sense. Or, they're applying for a $300 very high APR loan online but they live in a neighborhood of million dollar houses, what sense does that make? So you evaluate the identity for those kinds of things first and then you also look at the identity to say, have I seen anything bad at this address before, have I seen this phone number used on another identity before and if I've seen that phone number in another identity, that other identity....the address of the other identity I saw, did I see anything bad go on at that address?

That's referred to as link analysis and you kind of spiderweb the identity elements out to see if you can connect it to something else that we knew was fraudulent. Those are some of the methodologies that are used to try to trap and stop the fraud rings and it often is just not a single data element to say, oh, I found fraud at that address; it's sometimes a combination of things. Oh, they bank at Bank of America, they always declare a net monthly income between $1900 and $1950 and they always live in this neighborhood and so sometimes the link analysis gets pretty sophisticated, but again, you can point to the fraud and you can trap a lot of them.

Unfortunately with fraud, you have to have enough occurrences of a fraudulent identity being assembled so you can detect the pattern. Once with a detectable pattern then you can stop the rest of the occurrences that match the pattern. So always a couple of them are always going to get through.

Peter: Right, right. We're running out of time and I really wanted to get your take on the state of the subprime consumer because it's been written about extensively that, you know, the subprime auto challenges. It feels like there's been quite a few stories about that in recent weeks. And then The Wall Street Journal reported just last week that there are fewer people with FICO scores under 600 than ever before and those two things seem to be at odds. I want to get your take on the state of the subprime consumer in the USA right now.

Tim: Well I'll admit first that I've not read the Wall Street Journal article. Now that you've referenced it, I will go back and take a read on that at some point, but the drop in sub 600 scores doesn't surprise me. And the reason it doesn't surprise me is that back in 2006, 2007, 2008, 2009, when the economy imploded people were out of work, everybody...the mortgage industry melted down, there were foreclosures, everything else. There were a ton of bankruptcies, there were a ton of foreclosures, there were a ton of derogatory events that just crushed the credit scores on lots and lots of consumers.

If you think about the timing of that, that was all about seven years ago and literally, all of those events seven years ago caused those credit scores to tank about seven years ago. Those

scores, when they tanked, they caused those consumers to lose their ability to access new credit seven years ago and I keep repeating seven years ago again and again because I've got to make my point here. So those consumers for the last seven years, have not been able to get any credit and so over time, not being able to get new credit and no new credit means no new opportunity to default on new credit and those credit scores have cleaned themselves up over time by virtue of the fact that that population of consumers has had no opportunity to get new credit and get into trouble with new credit and further damage their score.

Seven years later, those foreclosures, those bankruptcies, those other defaults, those other really, really derogatory events on their credit bureaus are now rolling off their credit bureaus and their scores are starting to rebound because of it and so it's a natural progression and so you would expect the scores to rebound. What I would expect to happen at the risk of sounding...I may sound cynical, but this is judging the data, watching and believing we understand the behavioral trends, some of those consumers whose scores are starting to rebound are going to turn around and go back out and get credit. A percentage of those will then turn around and start to be challenged again in handling that credit and a percentage of those scores that have rebounded are going to un-rebound pretty quickly.

So a lot of the derogatory events that crushed the credit scores seven years ago essentially insulated those consumers from their own negative credit score impacts for the last seven years and now that that's kind of fading into the distance and their credit scores are rebounding, those consumers will now go get credit. So now what the lenders are going to find out is that two years ago a consumer with a 700 credit score was a pretty good risk. Going forward now those lenders are going to find that a consumer with a 700 credit score is more likely to default than a consumer two years ago that had a 700 credit score is likely to do. It is going to force a change in the underwriting strategies some of those lenders have to make.

Peter: Well that makes sense. There's lots more to talk about here, but we're actually out of time. I really appreciate you coming on the show today, Tim.

Tim: Well we appreciate the opportunity and always glad to talk to you.

Peter: Thanks, see you.

Tim: Bye.

Peter: I just want to go back to something that Tim said a little earlier and that is about real-time credit decisions. You know, we live in a world where there's an expectation of immediacy, people want to be approved immediately and sure there are companies that are doing that, but if you're getting an immediate approval what really should happen is that should be immediately sent out to a credit bureau so they now know that you are being approved for a loan and others can now see that if they're going to pull information on you.

I applaud Tim's company for doing good work here and working towards that goal and I know that other companies are doing the same thing. I feel like this whole monthly cycle is left over

from the paper statement days and paper tapes and sending a check through the mail. Those days are gone and I look forward to the time when all our credit information is shared in an instantaneous fashion. I think then there will be less fraud and borrowers will be able to have better pricing and I think it will be a better world for everybody.

Anyway on that note, I will sign off. I thank you very much for listening and I'll catch you next time. Bye.

(closing music)