LEND ACADEMY

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Welcome to the Lend Academy Podcast, Episode No. 274. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Peter Renton: Today on the show, I am delighted to be talking again with Jared Kaplan, he is the CEO of OppLoans. Now, OppLoans is focused on the sub-prime consumer and they partner with banks which we get into in some depth in this episode. Jared believes that the future of the sub-prime lending space belongs with banks, we talk about why that is, we go into, obviously, what's happened this year with his customer base, with his company.

We also talk about the new True Lender finalized rule from the OCC and what that means, we talk about the changes that he's had to make with underwriting and why this sort of was finally great in some ways to have a recession data because that's something that obviously many online lenders have never been able to provide before so we talk about that. Also, we talk about the future of the industry and much more. It was a fascinating interview, hope you enjoy the show.

Welcome to the podcast, Jared!

Jared Kaplan: It is great to be back, Peter, thanks for having me.

Peter: Yes, of course, I should say welcome back. It's been 18 months thereabouts since you were last on and I know a lot has changed in that time, but why don't we just kick it off by just giving the listeners a quick description of OppLoans so we all know what we're talking about here.

Jared: Sure. We're a financial technology platform that powers community banks to provide credit access to what we define as the "credit challenged" middle-income population. So, it's not low-income consumers, it's middle-income consumers, your US median consumer, and the idea behind the business is that half of the country lives paycheck to paycheck. You have 60 million Americans that lack access to traditional financial products and that's not my number, that's the New York Fed's number, they came up with a great study last September.

Essentially, if you have less than 620 FICO you're abandoned to the markets of last resort so banks are looking away to arrange credit in that population through our platform. They'll be able to do it in a seamless manner that gets the customer the best available product in ...a product that's structured in a way that should rebuild credit and ultimately graduate them back to mainstream financial credit products.

Peter: Right, right. Maybe can we just dig into that a little bit, the typical customer. I mean, you said they're like all sub-620, is that primarily who you're talking about here, what sort of income levels they are, that sort of thing.

Jared: Sure. So, the average customer makes $50,000 a year if they have a job, they have a bank account and they have a thick credit file, it's a not thin credit file customer. It's someone that did something terrible to their credit based upon traditional credit metrics. And so, the whole model is about finding that customer who did something bad to their credit actually has the willingness and the ability to repay and deserves a fair product to pay for whatever they need to pay for and then ultimately get back to the world that they used to live in.

Peter: Right, right. So, this might have been like a 740/750 FICOs at one point and then something happened and they went down to about 550 and now they're trying to claw their way back, is that fair to say?

Jared: Yeah, I mean, they could have been mid-600's, they could have been early 700's. What we find...you know, our customer on average, if you look at FICO data 550 to 620 customers' kind of a sweet spot, but they all had, at some point, access to more traditional financial products before their traditional score fell below that magical 620 line and that's where we're able to help these banks figure out who the best customers are and getting them a product that's more structured in line with their risk profile.

Peter: Right, okay, So then, let's talk about this year for that customer base and for your business....you know, take us through obviously from the beginning in March all the way through to day. We're recording this on the 2nd of November so take us through how this customer has...what's happened to them this year?

Jared: So, you know, back in late February, we started looking at the potential impact and we have this recession playbook that we had put together...I can't tell you how many times we are asked, what happens to the business in a recession. You know, we had the best answers, the only thing we didn't have was any data. (Peter laughs) The business was founded after the last recession so no one believed us so we were like, okay, now is the time to prove the resiliency of this customer, it is played out kind counter intuitively.

The customer, in some respect, has never been healthier from a credit and a cash perspective. One of the key alternative data points that the banks have adapted as per their underwriting models is how much money they have in the bank account and when stimulus hit in mid-April, these customers had five or six times the amount of cash that you would expect to see in their bank account in a normal market environment and so the addition of stimulus….the fact that they were not spending money on discretionary things like vacations, the fact that the number one deriver of the product is someone trying to fix their car that broke so they can get to work....our customer was healthy and they repaid debt at rates that we had not seen in the company's history and demand fell as a result.

So, what you had is a consumer base that was not borrowing because they didn't need the money and for this product which is a high cost product, it's a great thing, right. Customers shouldn't be willy-nilly taking money, taking loans if they don't have an emergency or unexpected expense they have to fulfill. Now, just from the second quarter on, very, very, healthy customer and that was great to see. We did see like 10% of our base skip a payment, we took a very, very generous approach in tandem with the bank partners when someone had any difficulty paying and out of that population 99% plus had become current so…..

Peter: That's great.

Jared: ….That's been quite a successful story, I think has built a tremendous amount of loyalty with the customer base. But now, we're at a really inflection point, you know, seven to eight months past the onset of the crisis, we have seen those same bank accounts dip to below where you would expect them to be. At this time, Peter, and that's a phenomenon here in the last couple of weeks and I think a direct result of a lack of additional stimulus, the fact that there is a portion of the population that's making less money than they did last year, you're seeing delinquencies return back to what we could consider normal.

That is a trend, well, we'll see what happens with stimulus, we all believe stimulus is going to happen ......you know, we can argue whether it's right after elections or early next year, but it will happen at some point. And that probably is enough to hopefully get the customer to the other side of this thing when the vaccine is more prevalent and spending patterns return more to normal. So, we'll see how it all plays out, but, certainly, not as we had thought early on, but thankfully for the customer, they've been able to navigate pretty well.

Peter: So, does that mean that loan demand has picked up. I imagine, it's picked up from second quarter levels, but has it picked up to pre-pandemic levels yet?

Jared: It's picked up considerably. I will tell you though, a large part of our acquisition is driven through search engine optimization through Google and other search engine traffic and so we tracked the major key words that drive that traffic. I would say we're still only about 60%, six-zero of what you would expect at this time of year so it's still actually quite muted. It looks like a traditional tax refund season still and....it's not surprising, right, because people are so....if anything, were gone, you know, backwards a little bit here the last couple of weeks, it's certainly in some regions, so it' still quite daunting from the peak which I would consider the early March.

Peter: Even though like stimulus is really....I mean, the unemployment stuff ended at the end of July, I mean, the stimulus checks went out April time frame so it's been months, months, so you're still seeing like a typical tax refund season?

Jared: Yeah.

Peter: It's really interesting.

Jared: It's just that the consumers are not spending as much nor do they have...I mean, I think some of the same drivers as before are still relevant. People aren't going on a vacation, right, you know, people don't typically use these products to go on vacation, but vacation drains the bank account so when something unexpected pops up, you don't have the cash so they have a little bit of extra cash because of that. And then, you know, we talked about car repair being a big driver so.... people are certainly driving less still.

And then the other major driver we see is payment for health care deductibles, for consumer driven health plans and people are less comfortable to go to the doctors still so there's still less of that activity going. So, I think it's a combination of factors, but it certainly is a moment in time. I would describe the demand in the space to be almost insatiable as late as early March of this year in the space. And so, we do think on the other side of this, it probably returns and maybe even returns with greater impact because we still have seen a number of the lending platforms above us stay relatively tight.

Peter: Right.

Jared: And that's a very....it's not as tight as it was in the second quarter, but certainly hasn't returned to normal. There's certainly a larger percent of those customers that don't have access to what they used to.

Peter: Right. So, that's ....I mean, you've had this, we talked about this last time, but you call your TurnUp Program, rather than turning down, you refer people on to the lower cost platforms, but are you finding that's happening less now because, you know, as you mentioned, a lot of them are much tighter than they were before. So, are you still doing that program and is it as successful as what it was before, as far as conversions?

Jared: So, the TurnUp Program, just to describe that, at the beginning of the application process is as a customer is applying, they are given the option of whether they'd like us to do a diligence search on their behalf for some 36% APR products. And so we go out to about 15 near-prime lenders and see if anyone has an appetite to the 96% of customers that opt into that process. Prior to COVID, we saw about 7% offer rates, 93% of the time there were no offers.

Seven percent of the time, a customer received at least one offer and through this period, we actually saw that the match rates dip a little bit. We were less successful at being able to find them other products out there and that's come up to about 7% again so we're a little bit lower than we were that's why I say it's still a little bit tighter. But, yeah, it definitely showed up in the April, May, June time period and it's come back a little bit, but not all the way.

Peter: Right, right. So, I want to talk about the industry as a whole. We've seen commentary from some of the Federal regulators that they want to see more banks get involved in the small dollar loan space. We had US Bank for many years now, their Small Dollar Program, recently, Bank of America are getting into it and Varo announced that they're going to be doing a very small dollar program, we've got Square. What do you make of sort of this increased kind of awareness of this product?

Jared: So, it's obviously a large percentage of the population that struggles to get access, right, so the regulators, for the longest time, have been trying to get more and more banks involved. For a number of reasons, banks are best positioned to offer products to this customer space, they can do it at the lowest price points, they have the lowest cost of capital, the cross sell is essentially free to them, if they have customer, if they have deposits which puts them first in line to get repayment, they have transaction data which help underwriting and you're thankfully seeing more banks get into the space now along with some of the financial technology companies that have bank-like products, like CashApp for instance, and that's a terrific trend, we've been surprised it's taken this long.

US Bank Simple Loan product launched in mid-2018 and it was....up until now, you haven't really seen many new entrants, but there clearly is a need and the more players you see in the space, the more ferocious the competition is and so consumers should have more choice.

The banks' offerings are highly regulated away so they should have the consumer protection and our thesis all along has been that banks should be the one leading access in the space and the big guys should be able to do it themselves. The community banks and the credit unions probably can't do it themselves and should be partnering with financial technology companies like OppLoans to provide the product and we're big believers that you can have access with appropriate consumer protection to create the best pathway for the consumer. We're finally seeing that happen and i think there can be a lot more to come on that note.

Peter: Right. So on that, I mean, you talked about when you described your company, you described it a little bit differently I think from in the past and you have this Powered by OppLoans offering. I was on your website last week and you have three banks that are on there now, I mean, it sounds like, from the way you're talking, this is what you see as the offering is. You want to power all these smaller banks to give them like a sub-prime offering.

Jared: Yeah. From our point of view, you know, there's 10,000 or so banks in the country, give or take, and more and more market share is shifted to the top ten guys over time.

Peter: Right.

Jared: The credit unions and the community banks have really been left out and financial technology is a great way to even the playing field for them. And so, we love the model, we've got three tremendous banks that we have partnered with that have outsourced potentially their small dollar platforms to us to power with our servicing and our technology and that gives them a really interesting product to compete in the marketplace. We just feel like it's the right answer for the space.

This space has a long history, right, and as you have coined a bit over the last couple of years.....and there's always this debate. I spent time in Washington talking to members of Congress, right, it's this debate over access, access at what price, what does the right guard rails look like and so we have taken the approach that banks provide the best medium for the reasons that we talked about earlier and we want to be the leading player empowering them into the marketplace.

Peter: Right, right, okay. So, you expect then that you're going to see dozens of these banks, you know, in the near future that will be powered by OppLoans? I mean, is this a core part of your strategy going forward?

Jared: Yeah. You know, I'm not sure if we'll have dozens of banks. I think that these banks....each one is a tremendous administrative burden reform to make it work. It's a great thing, right, I mean, banks are difficult, they need to be given the regulatory compliance and oversight that is demanded of them. And so, that is by nature passed on to us and we're lucky to have the partners we have, please, I mean, that is for sure, but it is a ton of work and creates numerous hurdles for us to go through to be able to get to market. So, I'm not sure how many more we'll add, but I think the space will see a lot more activity and a lot more innovation. So, that is ultimately a great thing for more credit access.

Peter: Sure, okay So, I want to go back and talk about this year again as far as the changes. Obviously, you've talked about how you'd never been through recession and now you've got that kind of ....the history of what has happened this year in your playbook, but how did you approach underwriting this year? Did you make any adjustments, were you using different data sources, what were the adjustments that you've made?

Jared: So, the recommendations we made to the bank partners, as far as the running models are concerned, always base on alternative data with heavy emphasis on bank data, on verifying income, on verifying consistency of income and that all played out quite strongly through this period of time. So, I would not say there were changes that were made, material changes that were made by the bank partners as we headed into COVID even with some of the uncertainty and the thesis played out pretty well.

You know, a lot of the customer base just given some of the underwriting attributes is concentrated in Amazon, in the post office, in drug stores, municipalities…parts of the economy that have proven to be quite resilient for this. So, I think that that was helpful as far as the banks and their books of performance through this process and it's one of the advantages that the alternative data has compared to the traditional data that many still rely on.

You're going to see that heightened even more coming out, there's been some press on what the credit score means now given so many customers who are flush with cash, have paid down debt and improved their scores is ....you know, yesterday's 680 is still the same today and what does all that mean. That will be very, very interesting to play out on the other side of this whereas the underwriting models that the banks use are still finely tuned to the same key points which is making sure someone's got the ability to repay and that's heavily driven by you make what you said you make and the consistency of income is such that you should be able to repay the loan over a period of time.

Peter: Right, that's interesting. I noticed that this consistency of income....you said this at LendIt a few weeks ago, you were talking about how it's really important not just to verify income, but to verify the consistency of income. How are you doing that? Are you doing that just through bank transaction data or are there other methods that you can use to verify consistency because, obviously, it has not been the most consistent year for many, many people.

Jared: Yeah. So, it's really a combination of data points all rolled into proprietary scoring, but at it's core it's very complex to judge consistency because that is driven by how many jobs you've got and what the frequency of how you're paid in those jobs and it can come in many forms of fashions. So, the proprietary technology that we developed can ingest all those data points in real-time and determine whether consistency is at the appropriate level that would allow someone to be able to repay a loan. I think that's a big part of our success when it comes to understanding who a customer is beyond some of these more traditional metrics that have been used historically.

Peter: Right. So, you're doing 1099 data, they might be driving for Uber or InstaCart or something and then they've got a W2 job as well, they might have a little consulting gig as well. I mean, you're able to kind of gather all that stuff in.

Jared: That's right. Gather all in and look at the history, look at the recency and have it all boil down to what is ultimately a proprietary score and whether it makes sense or not.

Peter: Right, right, okay. So, I want talk about True Lender because we had some movements. I think it was just last week. The OCC issued their final rule on True Lender and it was pretty much what they said earlier in the summer, how the new acting head of the OCC, Brian Brooks, was pretty adamant about this. You know, it's a pretty simple rule, I mean, it's like two sentences, so I wanted to get your take on the impact on the space in general and on your business.

Jared: I think even backing up beyond the installment loan space, the true lender thing is fascinating. If you look at the way that many credit card companies and mortgage companies work in tandem with banks, these partnerships are not novel. I think they are new in the installment world, but the shape and form of a bank partnering with another company to provide an asset in consumer finance is not new.

Clearly, lots of noise in the installment space for a long period of time and it's great to see the OCC come out with a bright line test and I think it's a big step forward for the industry. We know just in the way that we work with banks what those relationships look like and the amount of the control that they have over the programs and what we think are structures ......and, again, we just think it's another data point on the road to more mainstream credibility for these products which ultimately will create better opportunities for the consumer and so, hopefully, this will give lots more banks confidence to enter the space in some forward fashion.

Peter: Right, right. I do want to address....there's obviously opposition to this ruling and it may end up being lawsuits, we don't know, but .....and there's been several people that I've seen in public settings that have been highly critical of the space, highly critical of your company saying things that I thought were just horrible, but I wanted to give you a chance to address those. I know you've seen these criticisms, it must rankle you to some extent because I feel like what you're doing is good work and these people just don't appreciate it and they think what you're doing is actually opposite and is really bad for everybody.

You know, sometimes I think these people have wishful thinking where they just do magical thinking where.....you know, we've had AOC in Congress, there should be a 15% limit, no one should get charged interest above 15% ever, obviously, there's a 36% limit and there's people that really believe that your product should not exist. How do you respond to those people?

Jared: We respond with data. You know, we have a credit access crisis in the country, right, and so I have had lots of interesting conversations across the board and it's true, a lot of the opposition takes the point of view that 36% is the loan that (inaudible) right. It's almost...it's a very matter of fact point of view and so we love bringing the data from the top to bottom to that conversation and say, hey, we're trying to give the business away, trying to give it away and as you hear in big conversation before we launched TurnUp and we said, well, what if we're successful here and given the business away and no one needs the product anymore.

That will be amazing, we're fooling ourselves, I don't want to go to work everyday at a company that is taking someone in a really difficult situation because we can be fast, they're taking the product. That's not a business I want to be in. So, I think we have proven very clearly that there's tremendous demand out there, there's tremendous demand out there because access doesn't exist for the sub-625 population at sub-36% APR, it just doesn't exist.

That does not mean that there should be more legislation or regulation as it relates to consumer protection. I actually think we can do a lot more there as it relates to guard rails to ensuring that we have both access and consumer protection and there has been, you know lots of potential law and proposed law that have been pushed back that at OppLoans we are big supporters of, right, the CFPB payment rule being one of them.

Peter: Yeah.

Jared: And I think actually the space doesn't do itself any favors when it pushes back and what is common sense legislation or regulation to make sure there is appropriate balance. But, listen, if your point of view is you shouldn't get credit if it's higher than 36% APR or hey, the customer will just figure it out, we just fundamentally believe both of those are wrong. What we believe is that from an access standpoint, it is crucial that consumers have access, crucial.

It's crucial to have access with the appropriate protection and it can't be perpetual and this is where the big test in the space will come over the next 12 to 18 months, is which firms can prove that they really can help consumers rebuild credit and get back to the more mainstream financial credit products and that's where we're focused on, right. It's access with best-developed products approach, if there is another product, it's fantastic, if it's one of the bank products, great. Let's structure in the way that we build credit and then let's get them something that looks more like traditional mainstream credit product within a reasonable period of time and I don't see I'd argue with them.

Peter: Right, right. Obviously, you said you got them with data, I mean, what data do you have because I think it's a really good point. I mean, if we, as an industry, are not making the consumers' lives better and making them really more financially stable then we've failed, right. But I'd love to get some data that you can share about how that's actually working like your customer base, I mean, how are they doing better.

Jared: Right. So, that will ultimately be driven by two potential outcomes, right. Can you quantifiably prove that your credit score's improved over time with these products and/or you're able to get them to what we would define as sub-36% APR credit over a reasonable period of time.

Peter: Right.

Jared: You know, there are lots of data points that go into the first question, right. The loans that are offered on our platform are typically $1,500, right, and there are lots of other things customers can do with their behavior that will ultimately affect those traditional scores. So, we're working really hard with the bureaus to be able to tease out all of the potential impacts there and come with something that is incredibly quantitative that we can publicly report on to say, hey, customers that look like XYZ in this product, here's what happens to their traditional credit score and hope to be able to present that in real-time and we want a public dashboard, right, public dashboards shout out from the rooftops, here's what we have.

Peter: Right.

Jared: The other part we're also actively working on which is we are in the best position. For the longest time, we went around trying to convince near-prime lenders to take a chance on these customers once they've taken an installment loan and repaid it, right, and what's frustrating is that the 550 customer that improved to 570 or 590 or 619 still had no options, that the products on our platform were still the best option in town. So, as we've grown the business and gotten bigger, we've been able to generate more data and now in tandem with the bank partners, we're able to get much more about pricing on a long term basis in the current products so that, I think, is a big improvement.

But also, we're working on some real innovative products that will look like traditional mainstream products that these customers will be able to graduate to in a reasonable period of time. I hope they have some big announcement on that, it really is the first step next year.

Peter: Okay, that'll be interesting because I remember when we last chatted, I asked you about that, you know, you should be able to keep these in the OppLoans ecosystem. We'll look forward to announcements there. I want to move on and talk about something that I thought was interesting, you just recently announced this last month, partnership with Experian, Steady and BillShark, tell us about what you're doing there.

Jared: So, this is all as a result…. as it relates to our Social Impact Team which is doing a terrific job and the idea that financial education has to be a big part of our process in the way that we communicate with customers and there are really great innovative firms out there than can help our consumers, right.

Those three partners, I think, are at the top of the list and they all serve a different part of how we can help customers, but we are constantly looking for ways to expand the brand by bringing better products, by educating customers in how they can take care of their financial health and so that was our first foray after SpringFour, actually, which is the first one to launch earlier this year, which is another terrific company that helps customers find the methods and income that allows them to repay their loans. So, more to come there, but we want to have partners with the best companies in the space from a social impact perspective just to make sure that our folks know what's out there to help them.

Peter: Right, right, that makes sense, okay. So, we're almost out of time, but I'd like to sort of close with your thoughts on the future of the industry. I feel like this space....I mean, as you say I would have thought by now that you would have many direct competitors that are doing just what you're doing, but it feels like everyone's still focused in the more prime, near-prime space. It's not like you have no competitors, but this is less competitive, I think, you would agree than the prime space. So, maybe just talk about the future and what you would like to see happen to make this space a lot more mainstream.

Jared: So, unless everyone's income goes up and the cost of housing, child care and everything go down, you know, you're still going to have a major pain in the country, right, which is this dearth of savings. I mean, that is just the reality and there hasn't been much competition, historically, I think there's a number of reasons for that. I think it's hard, right, this is a riskier customer base, you can't rely on the traditional ways of doing business to do this profitably.

I think there's also been an overhang, right, there's, you know, reputational risk, some people think about headline risk, all of which we feel very strongly about. There's a right way to do this and our hope is to get sold to the banks, that's our hope. You know, banks are credible, they are mainstream, they are highly regulated and either by themselves or in partnership with financial technology companies should be able to provide much broader access and much broader access is more competition, means lower pricing and that's what I think you'll see.

I think the Fed regulators recognize that, I think they work with the banks, you've seen some great innovations so Bank of America's product is $5 for $500, right. I mean, that's a terrific product that they're able to get that up to scale and offer to their customer base so that's terrific, but it's not enough to fix your car, right, so there is that aspect of it, you know, the typical car repair cost $2,000 so there's still a gap there.

But, we're seeing the right signs and my guess is a couple of years from now, you'll see many more banks in the space, you'll see other financial technology providers powering them and, you know, what I said earlier rings true, companies are going to build their brand based upon customer outcomes here and the customer outcomes are ultimately going to be driven by how quickly you can graduate that customer to whatever we can agree as a mainstream financial product. So, we hope to leave the charge there and if there's some more competition on the way that will make us help to be that be much better, but it will also be a great thing for consumers and the space, in general, so we're actually big proponents of that and we hope it happens.

Peter: Right, okay. Well, we'll have to leave it there, Jared, but it's always great chatting with you and best of luck. We look forward to those announcements next year and good luck with everything.

Jared: Thank you so much, Peter, always a pleasure.

Peter: Okay, see you.

You know, one of the things that struck me the most in that interview with Jared there was he talked about the future really of the sub-prime space is with banks and it's really the reason why companies like OppLoans have done so well is because banks have ignored this group. But, you know, now that they really are aligning with banks, they got the Powered by OppLoans, product really focusing on providing banks with the opportunity to serve this population and....you know, it makes sense to me.

Banks have typically not been able to work out how to make money out of this population, how to serve them in a fiscally responsible way while also making a profit, it looks like what OppLoans is doing really is providing the playbook for banks in how to do that. So, it's going to be super interesting to see how this develops going forward.

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

Today's episode is sponsored by Lendit Fintech LatAm, the largest fintech event dedicated to lending, payments and digital banking in Latin America. It's happening online December 8th and 9th. Despite the pandemic, Latin America still remains the hottest region in the world when it comes to fintech with so much innovation happening. So, join the LatAm fintech community online this year where you will meet the people who matter, learn from the experts and get business done. LendIt Fintech, lending and banking connected. Sign up today at lendit.com/latam

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