



Podcast Transcription Session 23: Dave Girouard

Peter Renton: Welcome the Lend Academy Podcast, session number 23. This is your host, Peter Renton, founder of Lend Academy.

[music]

Peter: Today on the show, I am delighted to welcome Dave Girouard. He is the CEO and Founder of Upstart. Upstart are the new kid on the block, they've been around about 18 months, they've only really been doing the three-year unsecured consumer loans for a few months now and they are really targeting a borrower that is slightly different and it's difficult to underwrite. They feel like they've cracked the way to do that and we're going to learn more about how they've done that on the show today. Now full disclosure before we get going. I am an investor personally in Upstart's loans as well as through Lend Academy Investments. I have been using their platform now for several months and obviously, so far, it's too early to provide much of a judgment, but wanted to let you know that I am investing with Upstart today. On that note, I hope you enjoy the show. Thanks.

Peter: Welcome to the podcast, Dave.

Dave Girouard: Great to be here.

Peter: Okay, so let's just start off with giving the listeners a bit of a background about yourself and how you came to start Upstart.

Dave: Sure, I've been in the technology business for 20 plus years in the Bay area, small businesses and large businesses. I was at Apple in product management for a few years. More recently, I was at Google for eight years as President of Google Enterprise and it was really toward the end of that time that the notion of Upstart came to me. Really, it was an observation that young people aren't served particularly well by the financial institutions out there in the area of credit and that the way traditional underwriting works is really ill-fitted for people who are younger or earlier in their career. The notion, generally, was, you know, at Google we were hiring hundreds if not thousands of people in this age group and we were making hiring decisions very much driven by data. Larry and Serge always liked to make data-driven decision so, generally, the Google hiring model thought of it as of could it have been a proxy to an underwriting model to making a credit decision by understanding things that we looked at at Google like where they went to school, what they studied, how they performed academically because these are signals as to somebody's employability and earning potential and through that their credit worthiness.

Peter: So you sort of created a Google hiring model so to speak when you were there, did you?

Dave: Yeah, I was pretty involved in that and it was something where over time we were trying to better understand and predict who would be successful as employee at Google. Again, engineers run the company and their way of thinking is to use data to drive that more so than the subjective



opinion of mere human beings. We definitely had a bend towards using data to make hiring decisions. We didn't eliminate interviews, but we probably came closer to that than any other company.

Peter: Interesting, interesting. Okay, so then I know that you've got some co-founders there. Did your whole team of co-foundersdo they all come from Google or how did the team come together?

Dave: Well, the team today is about half ex-Google, but one of my co-founders, Paul Gu, who is really the data scientist part of the team was not from Google, he is actually a Thiel fellow. He won the Peter Thiel Fellowship for the kind of 20 under 20 where he got a scholarship to actually leave Yale where he was studying computer science and economics. I met Paul just at that time I was exiting Google to found Upstart and he decided to join me. We were both just very interested in the idea of using alternative data sources in order to model both income potential and credit worthiness of younger people. My other co-founder, Anna, was at Google with me for years. She ran G-mail Consumer Operations and a bunch of enterprise operations and she's kind of the operations guru at Upstart.

Peter: Okay, okay. You decided you wanted to serve these young people who really are underserved by traditional banks and also by even the other peer-to-peer lenders. You came up with this idea of Income Share Agreements which you launched with, why did you decide that was really the particular concept to launch with?

Dave: Well, I think we sort of wrapped up a few things together that maybe we shouldn't have in terms of understanding the issue of lack of access to capital. The concept that there's other types of data you could use to underwrite and then in the end we designed a concept that was really a new type of financial asset and Income Share Agreement which in the end we had some progress with. It has a lot of interesting attributes in terms of only having to pay when you have the money to pay which is really the design of an Income Share Agreement, but in the end it's simpler and a more mainstream product alone has shown itself to be much more readily accepted and able to grow very quickly in the market.

Peter: Okay, before we get to that, can you explain exactly how the Income Sharing Agreements work?

Dave: Yeah, sure, the simple idea is we model somebody's future earning potential and then set a price that suggests that. For example, if you want to raise \$20,000 you might share 2-1/2% of your income over the course of the next ten years. So, it was money today much like a loan, but the repayment was not based on a fixed interest rate, but based on your actual earnings and that's really where the underwriting and the sort of modeling started for Upstart.

Peter: Okay, okay, when did you launch exactly?

Dave: We launched that product at the beginning of 2013.



LEND ACADEMY

Peter: Okay, okay, sounds like you are well over a year into it. Early this year you made the big decision, obviously, because I've looked at some of your early materials, I've seen interviews and you really were talking up this new concept in financing which is the Income Sharing Agreements so it must have been a very big decision to basically abandon that, abandon the concept of really....your initial investors, obviously, believed in and you believed in, so what was the thought process around that pivot?

Dave: Sure, well, I don't think we actually think of it as much as abandoning, as much as just modifying the end of the funnel which is the product that we actually deliver the value through. We basically saw that it will be much easier to access capital because of the three-year unsecured loan product we have today. It's a very well understood product and, also, from the borrower it is a much simpler value proposition. Everybody understands a loan at a lower interest rate, a loan that's easier to get so the borrower experience and the actual weight to compare a loan is obviously almost universally understood. Whereas, the notion of an Income Share Agreement, it's pretty hard for a borrower to grasp. Is this a good deal or not, how do I compare it?

Peter: Right.

Dave: It's a difference between evangelizing a totally new concept where you need to educate the market and actually just walking into an enormously large market opportunity with a unique value proposition.

Peter: Right, that's fair enough. Can you just talk through like who are your typical borrowers today? Are you really just focusing on that young demographic, the people who just got out of school or are you broadening your horizons?

Dave: Our product is designed...obviously, some of the...the underwriting that we do has a lot of value for people who have less than ten years of credit history. Generally speaking, our borrowers are probably from 20 or 21 all the way up to 35 or so. So it's actually quite a spread and a lot of those borrowers would fall into what lenders would call a thin-file borrower to different degrees. Others aren't really thin-file borrowers at all, but they still like our product. It's generally.....all in as the younger borrower than you typically see on the platforms so there's certainly some crossover.

Peter: Right, so what are the terms you offer? As you said 3-year loans, is that the only product and what are the interest rates?

Dave: It's a simple 3-year unsecured loan, we don't have a 5-year product like the other platforms do. We may someday, but we don't today. It's a \$3,000 to \$25,000 loan, the interest rates can be as low as 6 and 6-1/2% and they go up to about 20%. They don't go as high as they do in the other platforms, but they are structured in a similar fashion as a unique rate for every applicant.

Peter: Where do you fit on the FICO spectrum? Some of these people, their FICO score will be pretty meaningless because they've got such a thin file that you...is FICO one of the data points you look at.



LEND ACADEMY

I mean, what type of borrowers, that's what I'm trying to get at, what type of borrowers are these? Are these prime, what kind?

Dave: Well, we, generally, are further than this future prime, meaning these are high quality borrowers who tend to have thinner than usual ...than typical credit files. In terms of FICO, you don't have to have a FICO score that the vast majority do and it tends to be in or about 700 average so these are actually high caliber borrowers in terms of FICO. They tend to have lower debt to income than you see in other platforms, grade for grade while you see that our borrowers have lower debt to income than what you'll see for the same equivalent borrowers on Lending Club or Prosper. That's generally because they haven't had the time to build up as much debt. They also have a shorter credit history so we require a lower debt to income. They are sort of different notionally. These are people with more free cash flow, less credit history than you'll find on the other platforms.

Peter: Okay, so let's just dig into the underwriting model a little bit because it's something that I know has garnered a lot of attention because you're looking outside the box with some of the data that you use. You talked about what kind of school, what kind of grades you use, I mean, what does...I'm just trying to picture for the listeners, a borrower comes along to Upstart, there might be a Stanford grad who is really two years out in the work force and has a very, very limited credit history, how do you decide, based on this limited credit file, what weight do you give to the fact that this is a Stanford grad they might have done a computer science degree or something like that. I mean, where do you draw the line as far as financial data versus this kind of sayone would say alternative data?

Dave: Sure, first off, we decidedly have not thrown out 30 or 40 years of underwriting history (laughs) so we start with the same notion any lender does which is trying to understand the borrower's financial capacity to repay a loan and also their kind of personal propensity to pay, kind of holding financial confidence. Do they have the characteristics and the likelihood of paying back a loan? We're very similar in that regard, we actually look at every credit variable others do in terms of understanding not just their FICO, but how many accounts they have opened, their sort of debt and other sort of existing obligations, how many increases had in recent times, etc.

We look at all of these things, but what we do that's different is we extend those by adding the educational variables such as where they went to school, what they studied, how they performed academically and the rationale of this, if you're looking at somebody at a moment in time and they're earning, well, let's just say \$50,000 and that looks like that's sufficient to pay a loan based on what you know about their other obligations, that's fine, but someone who has only been at a job for a year or two, you might not feel too confident that they'll be at that same job for the next three years. For us, it's important to understand their underlying employability.

Young people move around a lot, they change jobs so we use the educational variables not to replace all the credit and income variables, but to actually buffer them into a better understanding of how this person will survive in a downturn, what their employment prospects are irrespective of



this moment in time. We're really not as different as you think from others, other than we are adding a whole layer of data that others don't see.

Peter: Okay, when we chatted a few months back, you made a comment that you said 90% of your borrowers are from really top notch schools. I don't know whether you.....I think the term you used is schools, names that we would recognize, is that still the case, is that something you hold dear as far as the ...or is that just the kind of people you are attracting.

Dave: That's not quite accurate. I'm not sure I said all that, I mean, almost 100% of our borrowers are graduates of 4-year college so that's actually what's very unique about us. We're almost 100% 4-year college grads and that is one thing you can easily understand about us. But, beyond that, we're not just looking for Ivy League or Stanford or top, top schools, we're actually looking to get a better understanding of someone's employment prospects and we do that. It could be that you went to maybe just an okay school, but you studied a major that's very employable.

For example, nurses are very highly employed, they're very rarely unemployed for a long periods of time so nurses, generally speaking, can get great loans on Upstart. And even if you weren't in the most lucrative of majors and not at a really great school, if you had really high grades that sort of says a lot about you and employers tend to notice so we notice. What we know is really balance things like the quality of the school you went to, the area of study, and how you performed because those all are sort of pieces up the puzzle in understanding the likelihood of you paying back the loan.

Peter: Okay, so that's good. You're not just talking about the high tech industry. Nurses is the perfect example where these are people...yeah, you might have a nursing degree from somewhere, a school that no one has heard of, but the fact that it's a nursing degree, the fact that you somehow measured all the different types of careers that people have and the employability, I guess you somehow provide a school to each career choices. Is that sort of what goes into the model?

Dave: Yeah, a little bit. It's a regression model so all these variables conceptually operate independently; the quality of the school, the economic outcome of any particular major and then how you sort of rank against your peers. Those are all sort of signals in what amounts to in algorithm that is trying to understand your employability. That, of course, is added to the fact that you are today employed and making a certain salary and that's kind of a very strong data point relative to the others so we do balance them. Generally speaking, the educational variables are more predictive and more important the earlier you are in your career. The further you get along and you begin to have four, five, six, eight years of work experience as well as credit experience, the educational variables are less predictive and we weigh them less.

Peter: Right, okay, obviously there's a large population of borrowers out there. People are looking to borrow money for all sorts of things and we all know that the Lending Club and Prosper story about the debt consolidation. Is that similar to what you're seeing? What are the uses of the funds for your borrowers?



Dave: Sure, there's some things that are similar to the others and there's some differences. For sure, debt consolidation primarily credit card consolidation is our number one use case, not unlike the others and I guess it's no surprise. I mean, there's a lot of people paying high interest credit card debt. In our case, it's a lot of people who built up that debt during school or early parts of their careers and now kind of getting over it and wanting to move on. We have people doing other things like relocation, starting new jobs, large purchases, things you see in other members in the other platforms. We also have the significant number of people doing things like taking a coding course, they want to be a software engineer or in some cases refinancing high interest private student loans. We do have student loans use cases that aren't supported on the other platforms and it's kind of appropriate for our demographic.

Peter: Right, okay, okay. How are you marketing to...obviously, you don't want to give away any secrets, but I mean, how are you attracting these borrowers?

Dave: Sure, well, we use a lot of different ways and some of them bring us free borrowers and others are paid sources. To be a solid responsible company, of course, you have to develop a diverse source of borrowers and we're doing that, I mean, places that you'd imagine like large online advertising networks, through social media, through other types of platforms that direct potential borrowers to you. We're kind of opening that up very quickly and as of now, we have four or five different sources that are all growing and sending us borrowers with somewhat different economics to them, but, right now, our loans are profitable already by a significant margin and we're growing very quickly. We feel pretty good about where we are, but we definitely know that there's a lot of folks out there with compelling loan offers and there's more everyday. Being very, very good at finding new borrowers having a compelling proposition, doing that economically, doing at our scale is fundamental to our success.

Peter: Sure, sure, and on that note, as far as the borrowers go, do you find that a good chunk of them are ones that cannot get a loan elsewhere or do you find that people are saying...well, I'm going to go, I'm going to try and apply to Upstart or apply to Lending Club or apply to Prosper, I mean, what are you seeing as far as the borrowers' behavior?

Dave: Sure, most borrowers are going to look at multiple websites as quickly as they can, particularly ones that are able to give offers of credit very quickly. We definitely believe that people do look around and they should look around. Relative to Lending Club and Prosper, for sure a large part of our borrowers either couldn't get loans on those platforms because they don't have enough credit or work history or they could get them, but they wouldn't be at very compelling rates because that's such an important part of how Lending Club and Prosper do underwriting.

There's certainly some of our borrowers that can get good loans on those platforms either at a similar rate or maybe even at a better rate. It's not by any means a kind of perfectly liquid market where everybody gets the lowest rate, it's also not the only way people judge the quality of a loan. Our view of the world is that people are going to move quickly towards the best loan they can find



and you need to have the compelling value proposition, both in terms of the rates that you offer for a particular population as well as the borrower experience. That's something we're very focused on.

Peter: Right, okay, so let's switch gears a little bit on go to the investors' side of the equation. Just tell me why.....I am an investor, I know you're open only to accredited investors, I am an accredited investor who has an account with Lending Club, maybe Prosper as well, either or, why should I consider Upstart as an addition?

Dave: Well, I think we have accomplished something that the industry has been trying to figure out a long time which is.....there's almost a notion that prime borrowers are tapped out, that they've all been sort of sourced and we're done; sort of the way the US looked at the oil industry, right? Oil and the US, done, you've got to go get it overseas. What we're saying no is if you actually used different data that the others aren't using, there's an enormous pool, millions and millions of borrowers who are what we call future prime. They're very, very high quality borrowers, it's just that people don't know it yet. That's kind of the heart of our thesis is people in their 20's statistically default on loans at a lower rate than people in their 30's, 40's or 50's, a fact surfaced by a fed study.

Peter: Interesting.

Dave: But the issue is lenders can't distinguish between the high quality borrowers and those that are less so on the normal way they've done underwriting in the past. So what we have really is also a large influx of prime borrowers that others aren't able to find and that presents a unique investment opportunity. I would just say one of the important things, because we are a newer platform, we don't have seven or eight years of history is our target return to investors is probably at least a couple of hundred bases point higher than you see on the other platforms and it's really because we have unique underwriting and we're able to actually identify and make a great proposition to the borrowers.

Peter: So what you're really saying is investors can diversify into really a new population of borrowers at the same time, you're rewarded with potentially higher returns.

Dave: Yeah, when you're new in the market you're going to have a higher return and what we call future prime borrowers are people that should be part of any loan portfolio because they represent people with a lot of forward earning potential, people that have shown themselves by performing in school and that's our proposition in essence to investors,

Peter: Okay, okay, let's just go to the investment process a little bit, I mean, as I said at the top of the show, I am an investor, both personally through my company in the loans of your company at Upstart and I believe you're changing things here in the near future so explain how investors can access the loans at Upstart and what changes you are making.

Dave: Sure, one of changes we're in the midst of making right now is we were really the first platform to offer auto investing to everybody, meaning that every retail investor can invest at the same time with the same speed and the same automation that an institutional investor could invest



at. Well, we're actually going a step further. We're actually going to have all investing on Upstart be automated. What that really means is if you want to invest in Upstart, you can sign up on the website, you can choose any filters or approaches you want, if by grade or by FICO or some other sort of filter that you choose to set up and then you, of course, can set a budget, how much per loan and how much per week or month and we'll automatically invest. But what you won't be doing on Upstart is browsing through pages of loans and picking and choosing loan by loan. There are several reasons we're doing that that I'm happy to go into, but that's going to be the investment experience on Upstart is the notion of being able to filter and choose the types of loans you want, but it's all on a very automated process where everybody gets to see the same loans at the same time.

Peter: Okay, so then how are you going to....so a new investor signs up and you can't browse through the loans, how are you going to present them with the typical kinds of borrowers that they're used to seeing on the other platforms, I mean, how are they going to know?

Dave: Sure, you actually get to browse and see hundreds and hundreds of loans so you can get a sense of what a B grade loan looks like or an A or etc. so you'll be able to see tons and tons of loans, but you can really only invest according to filters or rules as opposed to picking them individually. In essence, we don't really believe there's a lot of value trade when somebody is trying to discern between two different B grade loans that look very, very similar. We feel that it makes more sense and it's more time-efficient for investors to be able to decide the type of loans that want upfront and to invest automatically.

Peter: Yes, I totally agree and that's why I've been sharing how I invest now for a long time and I'm a fully automated investor. I don't browse loans, you introduce human prejudices and I think it's much more efficient to decide on what kind of loans you want than just let it roll on. I think that's a smart move.

Dave: The big reason though, to be honest, the bigger reason is from the borrower's perspective which isin the other platforms if your loan happens to get funded as a whole loan, it funds very quickly and that's a good day for you, but if it happens to move into the fractional pool your loan might take up to two weeks to fund. As a borrower....borrowers don't really care about the notion of a market place. People just want to...

Peter:it's on the money, that's all they care about (laughs)

Dave:the money, yeah, so what we're basically saying is look we want everybody to fund quickly, we want to get to tell borrowers, you'll get your money maybe even tomorrow and to do that it's just at odds with the notion of letting loans fit in the market place where people can browse and pick. What you're seeing on our side is a focus on the borrower experience, meaning people will fund quickly, but at the same time doing it in a way that investors get to participate actively and on equal terms.



LEND ACADEMY

Peter: Right, right, so speaking of whole loans, are all your loans fractional today, are you going to have a whole loan program?

Dave: We do have a whole loan program. We announced just a couple of weeks ago that Victory Park Capital is investing \$100M in loans and they have been now buying for a couple of weeks, a few weeks now, and that's the really the launch of our whole loan program.

Peter: Okay.

Dave: They were having conversations with others, but we expect to have the mix on fraction and whole loans.

Peter: Okay, so let's just talk about the Victory Park deal. It's a \$100M, is a massive investment for someone...for a platform that's still fairly young, so how were you able to close a deal like that given your limited history?

Dave: Well, I think first of all, it's sort of what we discussed earlier. Our underwriting is not an enormous leap of faith because we actually use all the same criteria that every lender uses. We're really just supplementing the view of a borrower with the educational data and it's also very intuitive. People that go to better schools tended to default less, people that work hard and get a high GPA tend to be the same people that care about FICO scores and are very diligent about repaying their debts. So a lot of what we're doing is very intuitive and we actually have enormous amount of data to support it.

Second to that, when you just look at the loan book, when you look at the quality of borrowers today, you can look at the FICO score, the debt to income, any other attribute you want and what you'll know very quickly is it's a high, high quality book. So even though our history is somewhat short, what we've been able to do and what we can already show people today, I think, is good enough.

Peter: Okay, okay, so I want to just talk a bit about your target market and sort of the future of what you're planning on offering. I had Mike Cagney, CEO of SOFI, on the last episode, he is going after thehe's totally focused on the student loans to basically get the customer in and to start a relationship. I mean, you're not just totally focused on student loans, but you are focused on a young demographic that will presumably have financing needs throughout their life. Are you thinking down the road? Is Upstart going to be a company that will provide multiple loan products over the long term?

Dave: I think we're definitely somebody who will seek to serve the demographic in many ways over time with other credit products and who knows, the lot of the borrowers on our platform, probably more so than elsewhere, are people who will be high net earners within a few years. They may have credit card debts or student debts now, but if you project them five years out they're people that are creating a lot of wealth. So that's a very, very valuable customer and it's one any bank in the world would love to have. Naturally, we think that people in this age group don't have any particular affinity for banks. Banks are just kind of a neutral thing out there that they don't think much about.



LEND ACADEMY

We think there's an opportunity to build a brand and a company that serves them, more and more of their financial needs in a way that works for them. It's not designed around a bank and a building but designed around their life and the way they live. Credit... a simple, unsecured loan that radically reduces your cost of debt of your credit card is a great place to start and there's obviously a lot more that we can do there.

Peter: Sure and as you say, the people who are the 20-somethings of today are not going to have these long decades, multi-decade long relationships that their parents or grandparents might have had with a bank. They're going to look for something that's a little bit more innovative, they're going to look for someone online so I could totally see how a company like yours could...yeah, you could be the financial institution of choice as you go forward. Obviously, you're going to go beyond three-year unsecured consumer loans over the long term. That's fair to say.

Dave: I think it's fair to say and banks really I think have amazing infrastructure in terms of everything behind them on the regulatory part, the way cash is moving and managed, I mean, the infrastructure of banks is awesome, but the UX is a disaster and increasingly, I think what you're seeing is banks becoming...going from being retail consumer-oriented notion to wholesale-oriented notions where the UX is delivered by newer companies like us who are really thinking about the experience that the client really wants.

Peter: Okay, great, well, on that note I'll have to let you go, but I really appreciate you coming on the show, Dave, and best of luck to you.

Dave: Thank you, Peter.

Peter: Okay, bye.

Dave: Bye, bye.

Peter: Okay, Upstart are certainly one of the young companies to watch here in this industry, I think. They are targeting a slightly different demographic of borrower as Dave eloquently pointed out in the interview. These are the future prime borrowers of tomorrow and as such, we are trying to get at them before they are prime. The theory is that these people will be really solid borrowers, solid payers of their loan. As an investor, by including Upstart in your portfolio and you do get a broader diversification. Obviously, I am not providing investment advice here, but I have personally invested in Upstart and I've been happy with them, so far.

Anyway, on that note, I will sign off. Thank you very much for listening. I will catch you next time. Bye.

[closing music]