PODCAST TRANSCRIPTION SESSION NO. 201 - JARED KAPLAN

Welcome to the Lend Academy Podcast, Episode No. 201. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech Conference.

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Today's show is sponsored by LendIt Fintech Europe 2019, Europe's leading event for innovation and financial services. It's coming up on the 26th and 27th of September in London at the Business Design Centre. We've recently opened registration as well as speaker applications. You can find out more by going to lendit.com/europe

Peter Renton: Today on the show, I'm delighted to welcome Jared Kaplan, he is the CEO of OppLoans. Now OppLoans are an interesting company, they've been around for quite some time, but they're getting some serious traction these days so I wanted to get Jared on the show to talk about the products he offers, the type of loans they do, the type of customer that comes to them, it's a really interesting customer profile.

We talk about their approach to technology and underwriting and their, I think, unique approach to customer service which has really helped them seriously scale their business. And we talk about how they're funding their loans and what is coming down the pipe for OppLoans. It was a fascinating interview, I hope you enjoy the show,

Welcome to the podcast, Jared!

Jared Kaplan: Hey, Peter, thanks so much for having us, we're really looking forward to telling our story.

Peter: Okay, so you know, I like to get these things started by giving the listeners a little bit of background about yourself so why don't you tell us what you did before you got to OppLoans.

Jared: I started my career at Goldman Sachs in New York, and after a couple of years there, I went into the private equity investing world at a New York company where I ended up leading their financial services investing thesis.

I spent a bunch of time in insurance while I was there and in late 2011, co-founded an insurance business called Insureon that was based here in Chicago and Insureon was the first online property and casualty insurance broker to freelance businesses. It was my first foray into the operating world and had the pleasure of running many different parts of that business. We were the fastest growing online insurance brokerage in property and casualty.

About four years in, in 2015, I was approached by the Schwartz family here in Chicago and the Schwartz family is a prominent family here, Ted Schwartz had built a business called APAC Customer Services which was a well renowned customer service business/customer call center business that he took public and sold to JP Morgan's private equity firm in 2011. His son Todd founded OppLoans on the premise that after the Great Recession, there was large dislocation of credit for non-traditional borrowers and Todd installed this fabulous credit model and customer service model, but was looking for a CEO to scale the business. We had about 15 employees at the time and that's when they approached me to take the reins and grow the business.

Peter: Okay, so then what was it about OppLoans that really…it's a bit different to the insurance business, obviously with some similarities, but what was it about OppLoans that really sparked your interest?

Jared: So I was intrigued with the platform because there was actually a number of analogies with what we had built out at Insureon that I thought were transferrable. At the time we had no marketing, no proprietary technology, we had not built out a leadership team. The Insureon journey was all about doing those things and also delivering profitable business to our insurance carrier partners while as a lending business it's important to deliver profitable business as well and so the culmination of those things made it seem like we could pull a couple of levers early on to really change the trajectory of the business, but where I had to do the most research was on the actual customer philosophy and what we were selling to folks, what we were providing to folks.

I did not understand the space at all, it was foreign to me and I went back to my investing roots and I said to the Schwartzs, I appreciate everything you're saying, but let me figure out what the customer is saying here because that will tell me whether it's an interesting opportunity or not. And I spent a couple of hours listening to calls and I was floored. I'd say half the calls people were in tears, we had saved them so much money, we had treated them like a real person, we had taken the time to explain to them what the product was, we were highly transparent.

It was really unbelievably heartwarming and it proved to me there was a huge value creation opportunity here and then I went home and did some work on the macro realities of our country and the fact that more than half the country lives paycheck to paycheck, has very few options and certainly very few options that look to rehab and graduate customers out of this product. So I thought it was a very, very interesting opportunity and jumped at it.

Peter: So did it concern you at all, or did you…you obviously...the payday lending industry has a terrible reputation and, you know, while this isn't payday lending, it's certainly not low interest lending either so did it concern you, or what were your concerns about the reputation that this kind of thing, this kind of lending has?

Jared: I think the most interesting observation first was that the customer base was the median US customer, I mean, it was not a low income customer, actually it was not a customer that necessarily should be in the market of last resort in this space which are using your bank overdraft line or taking out a payday loan. So the fact that this customer made median US income, they were employed, they had a bank account, that was fascinating to me.

I also saw there was a number of different advantages that we could launch, that would highly differentiate the company. So I think the industry as a whole, that the non-prime space has gotten a really bad name for itself because of two reasons. One, you take advantage of desperate people, and two, you trap them in a cycle of debt.

The OppLoans model, I think, attacks both of those from a very positive perspective. The first thing we do is when someone finds us online, we actually do the diligence search on their behalf so to the extent there's a better, cheaper product out there, we will show the customer that product and we will say, hey, we're not the best option for you, it's very akin to the Progressive insurance model.

Peter: Right.

Jared: You can imagine that creates a tremendous amount of goodwill and customer referral business because someone whose car broke down yesterday needs the cash and found us because we're the easiest to find. We may be showing them a much better option for them to deal with that short term emergency expense.

The second thing is the product is designed to rehab you and to ultimately graduate you out so if you're in the product for more than 18 months we failed you and we're constantly looking at ways to evolve the product and reward customers and partner with other lenders so that once they have proven their, not only willingness, but their ability to repay, we can pass them along and say, thank you so much for the business, we've now paved the path for you for a more sustainable long-term financing solution.

Peter: Right, right. So then I'm curious just to get your opinion on the whole payday lending industry because…obviously, it sounds like your customer is not necessarily one that's going to that industry, but what do you do...I'm sure there's customers you get that just simply don't fit your credit box and payday may be their only option so what do you do for those people? I mean, the whole cycle, the negative cycle that payday gets people stuck into...I mean, how are we supposed to deal with those kinds of people?

Jared: Yeah, I think there's a large percentage of customers who don't qualify for our product, we don't think they have the ability to repay, we're not the right product for them, there's a lot more that we can do down the line to continue to offer solutions to those folks. The approach we've taken here as we've built the company...there's some really interesting third parties out there, companies like SpringFour companies like Steady that can provide pathways to other financing sources and/or supplemental income.

I actually think there is a robust place for other lenders that don't look like us who cater more toward a low income customer and there's going to be a maturation in that industry as well to kind of tease out the better actors versus the not so good actors. But just like we're providing a short-term pathway to deal with the situation and hopefully graduate to a near-prime lender, I think you can see the same processes work as you move down through the credit spectrum.

So we actually believe there is a wholehearted place for even high cost lenders than us as long as those two staples can be addressed; you're not taking advantage of someone in a desperate situation, and two, you're providing them an opportunity to improve not only their product but their credit profile longer term.

Peter: Right, right, okay, that makes sense. So let's dig into what you're actually offering. Can you tell us about your loan products, the interest rate, loan size, loan term, that sort of thing?

Jared: Yeah, so we're in about 40 states today, about half of those states we're directly lending and in another half of those states, we are an outsourced service provider to a Utah bank and the products differ slightly along those lines, but a general rule is we're offering about a $1,500 loan, it's about 12 months long and the APR's are just over 100%.

Peter: Okay, and then so when you have a bank partner, what's the difference between the two programs then, I mean, apart from the fact you've got a bank partner that's originating the loan, I presume, but are they really two separate products or not?

Jared: Yeah, they are really two separate products. The bank partnership came along, we had been approached...I think the bank saw that there was this very interesting opportunity in a number of geographies across the country where the customers' only option was a much higher cost, shorter duration loan and they had an appetite to go and originate in those states and to provide a product that was longer term, lower cost and longer duration.

And so that has worked very, very well and in the states where we're able to directly lend we have a little bit of a different product, just depending on what those state's rules and regulations look like. So we're offering actually many different products as you look through all of those maturations, but the end result is to provide a graduation path, a sustainable product to a customer who is in need and that has obviously been received very, very well in the marketplace.

Peter: Right, right. So then what do you say...people look at the APR and they just go, oh, I'm sure...we know about it, there's people running for president today, there's people in Congress today who want to make these kinds of loans illegal and they see an APR of triple digits and they think, oh my God, this must be bad, it's outrageous, we should shut these companies down that do this. What is your response to those people?

Jared: Well, I tell people my job is very easy because I tell people don't believe a word I say, go online and see what the customers say.

Peter: Right.

Jared: They tell our story. The Better Business Bureau, Google, LendingTree, CreditKarma, you name the social media platform...I just tell people, search for us and the testimonials are so unbelievable I think it shows the value that we're providing to the marketplace. Now I do think it's our duty, as we continue to get better, to reduce APRs and to continue to drive the best products to the marketplace so I think we're very, very committed to doing that. But our customers view us as a very, very cost effective product today versus their other alternatives.

The world is very interesting, how we grew up, right, you've got this 36% line in the sand and we wrote a whole white paper on how you got to 36%. There are two things that are very interesting with that whole dialogue. One is there are not great economic analysis that suggest that's the right line and the other piece is apples to apples across products, everyone calculates APRs differently so your bank overdraft APR, your credit card APR versus that installment loan APR. No one has really done the work to show apples to apples what the true cost of credit is across the spectrum.

And I will say for the customer we are trying to be the best option for them when you are turned down by the traditional marketplace and I think where we're at today from a price point perspective, we are the best option and over time, we should be able to reduce those APRs as our acquisition and our credit and our servicing and our cost of financing gets better and better.

Peter: Right, and the fact that you said when you're not the best option, I mean, I'd be curious to know how often that happens, is it 1% of borrowers where you recommend them to somebody else. I mean, tell us a little bit about that particular piece because I think it's a way to kind of, you know, get credibility...you're obviously not trying to trap people into some sort of cycle, but tell us a little bit about that program.

Jared: Yeah, so I think customer acquisition, in general, is a huge unique part of our business. Most companies in this space are heavily relying on direct mail or a third party affiliate to drive traffic, we actually have turned the acquisition model inside out so the majority of our traffic, the vast majority of our traffic is what I call organic so it's either through search engine optimization on Google or through customer referrals or it's through e-mail marketing and that generates a lot of activity at the top of the funnel.

About 10% of the time, we're able, today, to refer you to an Avant, or a LendingClub or a Prosper or another near-prime lender that can offer a cheaper product than we're able to offer and I would imagine that's going to increase over time as we build more direct relationships with lenders as folks view us as a brand standard for the right type of customer. We hope to drive a lot more...what we call "turn-up business" to other parties because if you can qualify for a cheaper product elsewhere, you shouldn't be in our product.

Peter: Right.

Jared: Now that means 90% of the people are still lacking other alternatives out there and for those folks we want to get the ones that have the ability and the willingness to repay into our product and then we want to rehab them and graduate them over time to those same near-prime lenders.

Peter: Right, right, okay, got it. So then I'd like to spend a little bit of time getting to know who the borrowers are exactly. I mean, you mentioned these are people with a bank account, with income, but maybe you could paint a picture for us with maybe some examples, but who are these people and what is their financial situation like?

Jared: Yeah, if you took the US Census data and you pick out the median US consumer, that is who our customer is. They're educated, they're making $50,000 a year, they have a job, they have a bank account, but they have no savings and their car breaks down or something unexpected medically happens and they just do not have an option for a couple of grand to finance that emergency expense. So that is our most typical consumer and it looks like your everyday American.

Peter: Okay, so then is there a use case, is it medical, is it car, I mean, what is the primary use case for the funds?

Jared: Yeah, if a car breaks down, auto repair or unexpected medical are our two top reasons that drive someone to search online and then, you know, we rank very well so they'll find us online, then they'll see our customer service rankings which are incredibly high and they'll say, that's interesting, and the next thing they typically do is call us.

I think the other trick to this model is you have to use technology to enable human customer service not replace human customer service. We've been able to do that very effectively, is create a human customer service for a customer who is in need and then build trust and make sure we give them the best price for their risk profile.

Peter: Right, I see your phone number is at the bottom of your homepage there, I mean, like are you open 24/7, I mean, how do you deal with...these people are not obviously just applying during business hours.

Jared: Yeah, we're always expanding hours, I think we're open until midnight most days, now during the week, certainly we're open to midnight, we're open until the early evening on the weekends…

Peter: Okay.

Jared: ...at some point here we'll be a 24/7 business and we want to do business with the customer when they want to do business in the medium that they want to do business, right. We want them to be able to go through the whole process without talking to someone if that's what they choose or if they need someone to hold their hand, we're going do that as well.

You know, there are lots of folks who will look at a business and think it has to be 100% automated end to end to really build scale and profitability. We look at it very different, we actually think the investment in our people on top of an incredibly efficient technology platform. Although it probably costs a little bit more up front, it pays for itself in dividends by being able to create a very efficient conversion funnel.

Peter: Right, right, So then I'm curious about...are you making money on...I mean, is there an origination fee that you're charging, is that part of the APR calculation there, I mean, what are the ways you make money?

Jared: It's an interest model…we essentially have no fees across the board and that is by design. The customer wants a simple product, they want to be able to understand the product. A plain vanilla 12-month installment loan that amortizes over the life of the loan where every payment is also repaying principal, the ability to pre-pay at anytime without penalty, we report to the three credit bureaus. It's structured in such a way that's incredibly easy to understand, where the money is being made on people repaying the loan and when they're ready they can get out of it with no strings attached, that is the goal.

Peter: Is it monthly payment, weekly, what is the repayment schedule?

Jared: We offer several different payment schedules. Most typically, it's a bi-weekly or monthly payment.

Peter: Right, okay. Let's talk about underwriting because this is really the critical piece. I mean, you said you've got a lot of people at the top of the funnel which is great, but how are you underwriting them? Obviously, you can't spend two hours on the phone with someone if you're going to lend them $1,000, I expect. Tell us a little bit about the technology you're using to underwrite.

Jared: Yes, so it starts with an incredible team of data scientists that have the benefit of lots of data to make sure we're getting the right borrower into the equation. We're not using traditional credit scores as a linchpin of the underwriting model, we're using alternative data, some from third parties, some internally sourced and a proprietary model that has constantly been improved over time as we've gotten more and more data to get to the right person.

The best analogy I give folks is we run it like a fantasy sports team and that's across the business. When you walk into our office, we've got a 100 flat screen TVs and they're all tracking a certain area of the business in real time with unbelievable granularity that we can drill down.

From a credit perspective, we are very, very sophisticated in understanding what is changing on a credit perspective on a minute-by-minute basis. So if some area looks hotter than another, we can drill down and figure out if changes need to be made before we have a bigger issue.

I think another core point of the underwriting perspective is to make sure you're always A/B testing, you're figuring out if there are new ways to approve more customers at same or better credit. We just rolled out our latest iteration of a credit model here recently that enables us to approve more at same or better losses and I think we're just scratching the surface in being able to increase availability of credit to this customer base.

Peter: Okay, so then are you...I mean, is this an automated process where you're not having a human being review each file, or is there some that gets kicked out to a human underwriter. How does it work?

Jared: Yeah, I think part of the secret sauce is being able to use technology to very quickly understand the attributes that are key for customers' ability to repay and willingness to repay right so that would be income accuracy, consistency of income, validating employment, validating identification.

We have some unbelievable proprietary technology that, for example, can take bank data and very quickly evaluate these items. If it's not clear whether it passes muster, we then have a follow-up process that allows us to quickly vet whether the customer has the income and the consistency of income, for example, to be able to repay the loan so it's a balance, right.

I think in this day and age every company needs some element of AI and machine learning to build their business. Every company also has to be wary that you may hit on disparate impact and that these models are being run compliantly and so we have balance between technology and manual processing in everything we do and throughout the way, we've been able to still create a very, very efficient business that can scale.

Peter: So then if someone comes along to your site today and fills out an application, how quickly do they get their money on average?

Jared: They'll get money next business day.

Peter: Next business day.

Jared: If they're approved today.

Peter: Okay.

Jared: And we're moving...I think same day funding is going to be a staple here very, very quickly so we're working across the business to move more to a same day model. I think within a year, all the customers will be same day.

Peter: So are ACH-ing this money to them, or they all have a bank account right so what's the method to get them their funds?

Jared: Yeah, today we're dispersing money through ACH.

Peter: So then can you give us some sense of the volume, the loan volume you're doing today, I mean, these are relatively small loans. It says on your website that you have 100,000 plus happy customers so give us sense of the volume you're at.

Jared: Yeah, I think the best way to think about it, across the different products and different delivery models, we're doing a couple of thousand loans a day.

Peter: Okay, okay, that makes sense. And then loan performance, I mean, this is going to be...obviously it's probably the most important issue that you face is being able to get a return on your money with good loan performance, what can you tell us about losses and performance?

Jared: These businesses, it's very interesting because the growth part of these businesses...I don't want to say it's easy, right, but growth in these spaces is, especially when you look at what the landscape looks like and the reality of savings in the country, the growth part is less important than making sure you can create a profitable business where folks are repaying you. So the only way you can do that is by managing your credit losses, right.

By far, it's the biggest line item for expenses in your P&L and we are as maniacal about credit as we are customer service and so the model has been built to generate well above average losses than what you can see out there publicly.

So I think we feel very strongly that our loans perform meaningfully better than what is typically found in this space, and again, that's also terrific because it's a virtuous cycle, the lower the losses over time, the more we can give back to the customer in terms of APR reduction. So it is the gift that keeps on giving and how we think about building the business long term.

Peter: Right, right. So do your customers come back multiple times, I mean, is this...you talked about in 18 months you want them out of your program, but what is the sort of the repeat rate of your customers?

Jared: Yeah, we find that 90% of the customers are in the product less than 18 months. The refinance piece of this business is always a very hot ticket item and there's two parts of that that we think through. One is we're a little bit more conservative up front. So for instance the customer may want $2,000/$2,500 and based on either our underwriting model or the bank's underwriting model, maybe the customer gets $1,500 up front and once they perform for a bit of time, they may be eligible for refinancing and they can top that up.

It's better for the customer because they'll end up paying less in interest by taking the money out in two tranches and it's good for the company, for our company because then we're ensuring we're getting the right borrowers up front. So that's one driver of refinance activity.

I think the second piece of it is building these graduation partnerships that we've talked about and we're in a number of dialogues whereby just based upon the fact that the customer has performed in our product, a near-prime lender is willing to take them back at a substantially lower cost.

And I think our goal is to get all the customers out by the 18-month mark and graduate them to another lender. Now they have to do their job too because we need this marketplace developed so we can make good on 100% of our customers and in the interim, we're looking at ways of rewarding customers who have been in the product and still want to refinance because there's not another option out there for them.

But wholeheartedly, I think in this space you need to make sure that the customer…it's a short term product for the customer and once they've proven the ability to repay, the've improved their credit and you can get them out of the product to a more traditional form of financing. That's critical to the longevity of this marketplace.

Peter: Right, right. So you don't have any plans then to go up market yourself like up the credit spectrum? You know, you've obviously got a lot of customers who are potentially graduating to…you mentioned LendingClub, Avant, Prosper, whatever. Why not have another product that is closer…like a more near-prime product?

Jared: Yeah, I think it's a possibility long term. I think today we have a tremendous amount of low hanging fruit to continue to deliver an unbelievable experience to our core customer, whether in this product or ancillary products. As the business gets larger and our cost of capital decreases, I think it would be prudent for us to look at some of these additional credit extensions to higher levels of the credit spectrum.

But we also love the fact that we can partner with these high quality businesses that are currently offering those products and potentially even develop two-way relationships where we can take some of their business in the near term and prove the credit worthiness so we can pass that business back to that lender over time. I think that's a very interesting model for us and we've been able to hammer out several high quality agreements on that front which is a benefit to both companies.

Peter: Right, right, okay. So I know we're running out of time, but I have a couple more things I want to get to. Firstly, how are you funding these loans, where does the money come from, who are your sort of outside investors who provide this capital?

Jared: So the Schwartz Capital guys are the majority owners of the firm from an equity basis, but we've been able to fund the business with operating cash flow to date from an equity perspective largely driven by the high quality relationships we have with a number of third party lenders.

I'd say our cap structure is relatively complicated...we have several partners who we have grown with over time and the key to these businesses is to continue to build credibility by doing what you're going to say and the lenders reward you with lower cost of capital and more flexibility in their cash flow.

So we have hundreds of millions of dollars of debt capacity at, I think, industry best cost of capital with flexibility in how we use that cash and that has really provided the funding capacity for our growth over the last couple of years.

Peter: Right, okay. So I saw that you were named a Glassdoor Top CEO in 2018, so I'm sure that's something you're quite proud of, but tell us about your approach to company culture.

Jared: We define culture as the excitement of the workforce on a Sunday night and how they feel about going to work on Monday morning (Peter laughs) and it's really how we built the business. I don't think it's mutually exclusive to build a very high performing culture, but also a best place to work so that is embedded in how we have developed the company.

For us, the happier the employees you have, the better customer service they deliver. Customer service is this huge advantage that we have, those customer service rankings online drive a tremendous amount of our business so we care about that. And I think we are always looking at how we can provide the best atmosphere to our employee base, right, and that is recognizing top performers, giving them opportunities to improve their education to move up through the organization and to provide a real growth path in a general workplace where we care about people and they can go and advance their careers.

At the end of the day, it's feeling good about what you do everyday. So the fact that our customers, a couple of thousand times a day, are having these tremendous experiences of people that need the product, I think that creates a really solid place to work. And then it's always about the team, so the fact that our senior executive team, I'd put them up against any Fortune 100 company, they are outstanding and that runs the gambit throughout the organization. We just have exceptional talent that works really, really hard, but treats people with unbelievable respect, recognizes top talent and that's why we've been able to build a great place to work.

Peter: Okay, so last question then. What's on the horizon for OppLoans, what are you working on that's exciting for you?

Jared: We view this as a platform, a financial services platform that's got tremendous extendibility to other products and to other types of customers. I think you're seeing lots of interesting things in the online lending space whether that's through point-of-sale, whether that's through some of these salary linked models, where you're able to offer much lower costs of credit through employers, where the repayment mechanism is through payroll deduction.

I think there are other financial services products, right, that we could certainly extend this to, whether that's near-prime credit, prime credit, mortgages. We view this as a platform that will be the leading consumer financing platform globally, for not only our customer segment, but across customer segments because we can deliver the product incredibly efficiently with unbelievable customer service so we are at a very early part of our journey and we look forward to building this out for years to come, not just here in the United States, but across the globe.

Peter: Okay, Jared, we'll have to leave it there. I wish you the best of luck. Thank you very much for coming on the show today.

Jared: Thank you so much, Peter, we appreciate it.

Peter: Okay, see you.

Jared: Bye.

Peter: Well no one could accuse Jared and OppLoans of thinking small, they clearly have grand plans. I think it's particularly interesting, the concept they have about referring those customers up the credit spectrum chain, shall we say, into a cheaper product. I think that's something that I would like to see more companies do and I think it really does speak to the kind of company that they are.

As I said, some people are going to see the headline rates and just dismiss them as a company that's not doing the right thing for customers. Clearly, that's not the case. You look at their ratings on a lot of these independent sites, their customers are clearly delighted with what they get from OppLoans so they're certainly a company to watch and I'll be paying attention as they continue to scale their business.

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

Today's show was sponsored by LendIt Fintech Europe 2019, Europe's leading event for innovation and financial services. It's happening September 26th and 27th at the Business Design Centre in London. Registration is now open as well as speaker applications. Find out more by going to lendit.com/europe

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