**PODCAST TRANSCRIPTION SESSION NO. 242–RAM AHLUWALIA**

Welcome to the Lend Academy Podcast, Episode No. 242, this is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech Conference.

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Today's episode is sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking. It's happening on our new dates of September 30 and October 1, at the Javits Center in New York. This year, with everything that's been going on, there will be so much to talk about. It will likely be our most important show ever, so come and join us in New York to meet the people who matter, to learn from the experts, and get business done. LendIt Fintech, lending and banking connected. Sign up at today at lendit.com/usa

**Peter Renton:** Today on the show, I am delighted to welcome back, Ram Ahluwalia, he is the CEO and Founder of PeerIQ. Now, PeerIQ has an interesting space in the industry, they're really at the epicenter. They're talking with investors all the time, talking to platforms all the time. So, I wanted to get Ram on the show because we're going through unusual times and I wanted to hear the perspectives he's seeing from both sides.

We talk about his investor clients and what they're seeing, what they're doing, how they're assessing risk today in a very unusual environment, talk about how the consumer lenders are responding, the small business lenders. We talk about the securitization markets and how that shut down and we talk quite a bit about the PPP, the Paycheck Protection Program, that has just come into place and much more. It was a fascinating interview, I hope you enjoy the show.

Welcome back to the podcast, Ram!

**Ram Ahluwalia:** Thanks for having me, Peter.

**Peter:** My pleasure. Okay, so we should give the listeners some context. We're recording this on April 3rd and we're in a very fast moving world right now. So, as you're listening this, keep that in context. So, maybe let's start, Ram, by just .....maybe share with the listeners what the past couple of weeks have been like for you personally and what they've been like for PeerIQ.

**Ram:** Sure. The last four to five weeks have been extraordinary, I'm sure, as it had been for your listeners also. Personally, my wife, who's a software engineer at Bloomberg, we're both working from home, day cares shut off so we're doing what we can to shuttle our little guy back and forth and get work done and also lead four organizations.

From the company perspective, the first week of March, we had a call over the weekend when we saw corona virus cases were growing, you know, in New York City at that time, the case count was very low, but it was clear that this was an exponential, you know, the parts of the world such as Italy and the view was we're all going to be working from home virtually at some point, the question is when.

This is a freight train you'd rather get out of the way and anticipate and have some semblance of control rather than be forced inevitably through, you know, an appropriate government policy. So, to that end we implemented virtual work from home training, we adopted a set of best practices and tools, codified that in a document. We had optional work from home the first two weeks; within three days, everyone was working from home except for one super trooper holding the fort.

So, the second component of that was customer reassurance as well, so this was really going to mid-March. So, once we were effectively executing remotely which....you know, it's difficult to have a data analytics business, but I think we maintained our productivity levels. We focused on customer reassurance letting them know that we're here to help them and serve them. Fortunately, we had our first year of cash flow positivity last year, which was great, and doing the best we can to help them man that risk. I think the one area of that's been disappointing has been recruiting, of all things.

We had two candidates, one from a top four consultancy, the other from a blue chip credit card company in New York, you can probably guess, and both of them said, look, they just want to kind of stay where they are and not take the risk of moving to a startup. So, that's been our experience.

**Peter:** Right, right, okay, makes sense. So, you're at an interesting position here being a data analytics company and the data that is coming out has been, I'm sure, just kind of unprecedented, but before we get to that, I'd be curious to hear about...... you work with a lot of investors, a lot of large investors, I've spoken to several over the past week, what are you hearing from your investor clients?

**Ram:** Sure. So, investors are finding that financing loan purchases is difficult, so in a CUSIP market....and you've seen this roll down back to the originators, right. In a CUSIP market, it's very difficult to roll over your positions. CUSIPs are financed through overnight repo and also haircuts are increasing, so, you know, it’s simplistic but it's a fair analogy, you can start thinking like a margin call. You need the ability to fund your CUSIPs, otherwise, you're not going to be able to extend and buy new loans, so credit facilities, in some cases, have been tapped out, or canceled citing the material adverse conditions. Investors are enjoying incentives so some lenders are sharing in the origination fee with investors or selling loans below par so they can capture some kind of revenue.

There's, obviously, a big uptick in the need for data and analytics, we're in the risk off world.... this is a risk management problem now so doing what we can to help them. On the lenders’ side, lenders are raising rates. You saw a few days ago, Lending Club has raised rates ... everyone has to in order to make this an attractive product for investors. Lenders have cut back [originations]....in general terms, they've cut back substantially, some of the large lenders definitely in the double-digit range, 40/50%, some other lenders I have seen 90%.

I haven't seen lenders fully shut off, there's definitely been tightening in underwriting by industry type. I think most of that tightening goes back to capital availability, more than anything else. There's also concerns that lenders have that consumers, in this barrage of information, might choose not to pay their consumer loans confusing mortgage forbearance, for example, with the need for them to continue to pay their consumer loans. There are some bright spots. One lender has had a record origination month. Last month, they financed products, I can't name the product they financed, but it's a niche seller and the type of product that people buy during times of stress, not toilet paper (Peter laughs).

**Peter:** Right, right, okay. So then, one of the things that's really interesting about today is that…. there's a quote from Jared Hecht, who's going to be on the podcast next week, he was quoted in The Wall Street Journal earlier this week basically saying, "no one knows how to underwrite risk in today's climate." So, what are you seeing and what.....like you're a data analytics company, I feel like this is unprecedented, but how do you help your clients model risk today?

**Ram:** Yeah, it's absolutely unprecedented. We saw that in the last two weeks, we lost 10 million jobs behind a plane right sticking up. We probably have another 10 to 15 million more jobs that will be lost, so yes. That said, I think there's a split between small business and consumer risk. Small business not an understatement, they will experience substantial losses, particularly those sectors that are most exposed to the crisis, travel, retail and so forth.

Consumer, I think, will actually be better than most believe due to the tremendous policy response that we're seeing. There will be losses that take place, some of that will be attributed to the lack of planning and orderly distribution of benefits, you know, websites being done for unemployment insurance, so some of the challenges even in the PPP program which will impact employment levels.

So, on the consumer side, I think you can still go out there and underwrite; small business, though, is no question is extraordinarily challenging. From the consumer perspective, you can use the loan level data, you can map that to geographic state-by-state unemployment benefits which matters, you can lay around the federal benefits, you can identify where there's been mortgage payment, or debt relief. So, you can do the math at that level and I think do a robust bottoms up assessment.

**Peter:** Okay. So, what about other data points? I'm curious...maybe some of the things that you haven't mentioned yet that could be a good indicator of risk right now?

**Ram:** Sure. Now, this is primarily a health issue that has become an economic issue, so certainly the hospitalization rates for coronavirus cases is a good metric to look at, it's not biased from the dispersion and testing that we're experiencing, so that's number one.

Second, weekly unemployment claims is a very good one, generally, that's a lagging indicator. In March 2009, was the highest monthly of job loss, it is also the first month that started the recovery, but this is an unusual time period where leading and coincident indicators are, generally, on top of each other, so that's a good one.

In terms of real time data, obviously looking at real time delinquencies on risk platforms such as ours, looking at delinquencies through service reports. If you have more exposure to non-prime risk, I would recommend looking at the Monthly Remit Report from OneMain which has been around for over a hundred years to get a good sense about how that population is performing.

If you have prime credit risk, I would look at data from the credit card in master trust/ABS programs, and then I would also focus on just asking questions around market functioning because some of the challenge of the past four weeks is that certain markets has stopped functioning normally; the repo market, the municipal bond market, the risk of mapping rollover investment grade debt. Fortunately, there's been so much action and firepower that the Fed and Treasury have taken in that. I think most of these has actually been addressed, but it's something to keep an eye on.

**Peter:** Sure, okay. So then, one of the markets that's also closed off is the ABS markets, no one can get a securitization closed right now. What impact is that going to have particularly on the consumer and student lenders?

**Ram:** Well, it means less ability to originate because the channel that can deliver scale funding securitization is shut off, so you have to find other pillars of capital to lean on, it's extraordinarily challenging. Securitization relies on a gain on sale model and right now, lenders are selling loans at below par, so some lenders are in a negative unit economics position. You know, warehouse lines are pricing wide, sometimes securitization markets.....you know, in Q1 2016, we saw certain lenders go to securitization markets any way, just so they could clear out the facilities and originate loans and capture origination fee.

This market shut down so fast and swiftly they were unable to do that, so it means higher rates for consumers, higher rates for small business. I think the other takeaway is that it's abundantly clear that fintechs and non-banks need to find a distribution channel through banks, absolutely clear to have to be the case. Yes, there's a very important role for institutional investors and providers of term capital like private equity, someone who used to take on the first loss position and enable credit extension to riskier and underserved credit segments, but the primary challenge that there's no clear ability for fintechs to distribute loans from the banking sector.

**Peter:** Right, right. On that, I was actually speaking with someone at one of the consumer lenders earlier this week and they said, yes, the institutional investor channel is, basically, closed. There’s really very little money coming, but he said, the banks and credit unions are continuing to invest. Is that what you're seeing across the industry?

**Ram:** Yes, institutional investors have a couple of different stripes. Some are committed to the category so they will re-invest principal and interest and they'll take advantage of these incentives. I would also say that there are some players that are now really in a beautiful spot. For example, like Cross River Bank where they are a commercial bank and they're also a partner-funding bank and, therefore, they may be able to benefit from somebody's programs that are launching and help provide liquidity in different kinds of ways, but, yes.

Overall, if you're an investor and you're looking across capital markets on a relative value basis, why wouldn't I buy a bond that has a comparable coupon after you adjust for losses, but also have assets and have recourse to the entire company's balance sheet? So, investors are behaving rationally and there's a main lesson and what we learned in this crisis is that when losses are going up and unemployment is increasing, the only mechanic to enable markets to clear is for loans to trade below par, or for lenders to give up a portion of the origination fee and that's not a sustainable business model.

So, you have to open up distribution to banks. Banks and credit unions, they recognize they don't have technology, they recognize they don't have a first class customer experience, they also have access, particularly the smaller credit unions and smaller banks here I think it is most relevant for trillions in deposits.

**Peter:** Right, right, okay. So, I want to get back to the securitization because I've been seeing some ratings agencies emailing this week talking about potential downgrades on some of the existing transactions that are out there. What are you seeing on that front?

**Ram:** Yes, Kroll put ten small business ABS deals on Negative Ratings Watch, they're the most active ratings agency in the marketplace lending space. They have not put any MPL bonds on downgrade, or negative ratings watch yet. The ratings agencies are going to wait to look at what the April Remit Reports look like and they'll take action from there, and then we'll see, I mean, it's just going back to the policy response.

It's been fast and swift, the mechanics have been a bit disorderly, but the policy response should enable the vast majority of consumers, both W2 and 1099 to bridge through at least the next ten weeks and then we'll re-assess at that point in time by the policy makers and they should have made it clear that this is an installment approach to the crisis. So, it's not clear that there are consumer MPL bonds will experience the kinds of losses we saw in 2008, even though the unemployment rate and the number of job losses will likely cause that.

**Peter:** Yeah, because if we can get the stimulus out, I guess, there will be....people will have some money. I mean, there's been talk about a fourth package coming out and let's just talk a little bit about that. Today, this is the launch, official launch of the Paycheck Protection Program and we're recording this sort of halfway through the day and it hasn't gone smoothly.

Right now, there's some loans that appear to be going through….. like Bank of America is one of the big banks and they have strings attached to their loans. Originally, I thought when this was coming up, I thought this was going to be fintechs' time to really shine, but I'm unaware of any fintech that has been approved yet and that this part of this. So, what are you hearing about the PPP?

**Ram:** Yeah, you've got a good write-up on it this morning. I think there are a couple of opportunities and challenges. So, the SBA's Lending Program last year was about $23 Billion in size. For this program to be effective, the fintechs are essential to help to originate loans and the provider of capital is the major issue. That provider of capital, as we discussed earlier, has to be the banks in order to make the economics work. You saw that Treasury Secretary Mnuchin upped the interest rate on this PPP loans to 1%, which I thought was a good move. I would actually suggest they go a bit higher than 1.5% so that you can motivate banks to profitably fund these loans and hit their ROE objectives, that's one challenge.

The second is it's not clear who will bear the responsibility for rep and warranty violations, or fraud claims. On the one hand, the policy makers have aired on the side of maximizing response and trying to move as fast as they can. At the same time, banks are held to a high standard so they care about Know Your Customer rules, Anti-Money Laundering rules, Bank Secrecy Act rules, so they need some type of guideline, or safe harbor and without that, I don't think you're going to get much uptake. From the big banks that I've recently pooled, most will initially focus on their customer bases today.

I think it's a huge opportunity for fintechs, except fintechs need to be thoughtful about their origination process, meaning we'll look back at this a year, two years from now and we'll measure what were the fraud rates. If fintechs apply a set of standards that banks hold themselves accountable to, except they do it better, faster and cheaper, then we'll be building the case for regulators that this temporary channel that is linking fintechs to the banking sector should become a more permanent channel. But, you're right, there are definitely key issues to work through, it looks like there are a bit around and, hopefully, next week we will start seeing loans printed.

**Peter:** Yeah, yeah, that's the point. Here at LendIt, we're applying and we've been in touch with our banker there saying Monday we should be able to apply. You know, I spoke with a couple of fintech companies this week, actually spoke to several and one said that they really want to be on board, they're applying to be approved, even though it will be a loss making product most likely, but they want to be part of the solution.

Another said, they can't make it work, it's just where it is right now, the economics are just simply not viable, so I think maybe we'll see some changes down the road. But, the thing that we haven't seen yet is....I mean, I feel like we're still in the early innings here, we're going to have...once we get every bank out there that's open then we're going to see how long this is going to take, are people really going to be approved instantly. I mean, our banker said you can only apply online which I think is good and it's a pretty simple form and given that we have an existing relationship with them, that's the most we would like to do, we have to go to our existing bank.

So, I mean, at least fintechs are out in the cold a little bit, but I feel like.....I mean, maybe it's always possible there will be a second round here, although we are re-jigging all the rules because I feel like.....I originally thought, this was fintech's time to shine, but it may not be. I know it's hard to stare in a crystal bowl at a time like this, but how do you think the small business lenders on the fintech side are going to be able to get involved?

**Ram:** Most of them have expressed interest, at least from what I was formally told. The economics on the origination fee, as you know, were up to 5% with a loan interest rate at 1%, there's definitely a workable business model there and there are definitely very prominent small business originators that are focused on developing an origination machine around that.

I think the regulators are improvising swiftly, so if we're seeing that the take up on the PPP program is falling short of the goals again, that had cost $347 Billion range, you're going to see more permissiveness. And so, I do think that, actually, it's a good opportunity for the fintechs, probably the fintechs that are linked, or partnered with some partner funding banks.

**Peter**: Right.

**Ram:** They are in the best position because, you know, if you're Cross River, you have oversight over compliance, customer disclosures and you yourself are held to bank standards, so that intermediation function, that stamp of approval function could be an important conduit to help the small business fintech originators deliver loans into the banking sector.

**Peter:** Right, right, yeah. I certainly hope that we're able to come in here. Pretty much every fintech lender, not everyone, but on the small business side has a banking relationship. They might have a banking relationship, but the cost of capital is going to be greater than 1% in a lot of these situations.

**Ram:** Right.

**Peter:** I mean, origination fee is enough that you can.....that provides some cash flow up front, but do you see any outside investors, other than banks, are going to take up this proposition?

**Ram:** No, it has to be the banks, it has to be the banks in order to make the economics work and the supply of capital. So, you know, the fintechs will focus on origination and servicing and then selling the asset to some banking institution and potentially sharing the economics through multiple different ways to motivate the banks to buy these loans. So, those pipes need to be built, they need to get worked out, there are a lot of issues around that, we touched on some of that earlier.

If you're a bank buying loans from a thinly capitalized fintech and you're buying tens of billions of loans, but the fintech has maybe tens of millions in equity capital then how do you enforce your reps and warranties that there are applications down the road that do not conform with the policy and the PPP, right, for instance. So, those are some of the challenges, but there's no question, you need to have distribution built up for banks. The fintech market does not have the balance sheet to absorb these.

**Peter:** Right.

**Ram:** And also, the mechanic around the loan forgiveness needs to be spelled out so banks can plan and the mechanic on how banks can, you know, put that risk to some other buyer needs to be clarified as well, presumably the Treasury.

**Peter:** Yeah. So, another thing that .......speaking of Treasury, I wanted to talk about another piece that came out. I think it was actually not this week, but last week, was the Fed re-established the Term Asset-Backed Securities Loan Facility, TALF it's called, and basically they started in 2008 in the financial crisis and they did not include personal loans...obviously, student loans, auto loans and credit cards, that sort of thing, what are your thoughts on TALF and can we get this changed to include consumer loans?

**Ram:** It's an extraordinary program, it was very effective in 2008. Essentially, what TALF enables you to do is unclog funding markets for high quality assets. As a participant in the TALF program, you can borrow at the same rates, essentially, at the Federal government without recourse, so it's an extraordinary program. So, the challenge we talked about earlier around the CUSIP market and the credit facility market could potentially be addressed with the TALF program. Now, TALF in the 08 market was coped to focus on investment rate and rated securities. Yeah, personal loans in a loan format obviously don't meet those criteria so we need to think about how to make that work.

One way to do that would be to have, essentially, a credit facility that's provided by the Federal Reserve and have all of those collateral rules that govern the haircut and the dance rate (?). It's much in the same way that investment banks provide funding to fintechs. In fact, I think the proper way to do it is to enable the investment banks to fund via their primary dealer credit facilities to the Federal Reserve. That's the cleanest way to do it because you also have all the machinery allowed monitoring and the contracts and the due diligence in place to....but, I think that's the way to make it come together.

**Peter:** Right, okay. We're running out of time, but a couple more things I really want to get to. There was some interesting talk, an earlier version of the CARES Act had a digital wallet of sorts, a Fed account they called it, where basically money could be distributed to people without bank accounts and you could have a direct account with the Federal Reserve. Do you think we're closer to a Central Bank digital currency now than we were a month ago?

**Ram:** Absolutely not, I think that's a zero, right. The Central Bank and policymakers are putting out fires to design and deploy a central digitized currency, it requires a lot of thoughtfulness and planning and comment period. It also disintermediates the banks that would object to that, doesn't mean that that's not a good idea. I don't think it's a priority for anyone to focus on that at this point in time.

**Peter:** Right, right. This is something that if you had it already, you would certainly take advantage of it, but, yeah, this is probably not the time. (laughs)

**Ram:** It's new, it's novel, it's interesting. People have a couple of extra hours work from home, they can kind of write about it and kind of do the simulation of what would have happened if we had this, but if you look at the digital currencies out there, they're not doing too well either, although this is serving a different kind of purpose. I think a better response is what you saw from Chime where they're enabling rapid account opening and then enabling the efficient disbursement of these direct payouts and funds to, you know, impact individuals. That's a far more practical industry response.

**Peter:** Yeah, yeah, I completely agree. Okay, so then, at the risk of....you know, obviously, being out of date by the time this publishes (laughs), what are some of your closing thoughts here about where this is going and how we are all going to come out the other side.

**Ram:** Sure, sure. So, I think the mantra here is don't let a good crisis to waste. There are three things here.

One is the acceleration of digital, it's happening. In some cases, it's happening by law, as you pointed out, regarding the applications for several of these programs, so that's a great.....that's a long term trend in the favor of fintechs.

Second is service, service, service your customers, engage with them, don't take loan payments for granted. Customers are getting a deluge of information, you need to engage and service them.

Third is hold yourself to a higher standard, so if you have the opportunity to originate loans and sell them to a bank and capture an origination fee, aim for the same kinds of standards that banks hold themselves to, in terms of fraud and any money laundering and Know Your Customer because if you can do that, you can win the long game of opening a more permanent, reliable channel to distribute loans in the banking sector which is a natural marriage.

**Peter:** Okay, we're going to have to leave it there, Ram. I really appreciate your coming on the show today.

**Ram:** Thank you, Peter, have a good one. Take care.

**Peter:** See you.

One of the things I think is interesting, and Ram touched on this, that is the difference between the small business lenders and the consumer lenders. Now, many small business lenders have just stopped lending completely, so many small businesses are dormant, just not operating right now with no revenue coming in and it is just very, very difficult to underwrite small businesses.

Whereas, consumers, none of the consumer lending platforms, none that I know of anyway, have completely shut down, they're lending, I would say many, or I'd say most have tightened their credit box, some considerably, but it just points to, I think, the different kind of perspectives we have in the consumer is while many of them are losing their jobs, many of them also have savings, particularly the more prime consumers.

So, you're probably not going to see as big of a shock on the consumer side as you are on the small business side, particularly until we start to see the Paycheck Protection Plan, the PPP, until we start to see those funds flowing readily to all the struggling small businesses.

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 was sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking. It's happening on our new dates of September 30 and October 1st at the Javits Center in New York. This year, with everything that's been going on, there will be so much to talk about. It will likely be our most important show ever. Come and join us in New York to meet the people who matter, to learn from the experts and get business done. LendIt Fintech, lending and banking connected. Sign up today at lendit.com/usa

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