Podcast Transcription Session 29: Scott Langmack

Peter Renton: Welcome the Lend Academy Podcast, session number 29. This is your host, Peter Renton, founder of Lend Academy.

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Peter: Today on the show, I'm delighted to welcome Scott Langmack. Scott is a name new investors might not recognize, but back in 2009, he was instrumental in bringing many new investors to Lending Club. He helped spread the word and helped create sort of a system of best practices for investors. When I first got involved in this industry, the series of webinars that Scott Langmack helped do for Lending Club were instrumental in really helping me get educated about the space. When I first discovered them, I felt like it was a goldmine. I watched all of these webinars over the course of a couple of days. I've wanted to get Scott on the show because he is one person that's really seen Lending Club evolve from those very early days through to today. We met up at the Lending Club IPO last week in New York. He agreed to come on the show and share his thoughts about really the evolution of Lending Club and also where it's going. Hope you enjoy the show!

Peter: Welcome to the podcast, Scott.

Scott Langmack: Thank you, Peter.

Peter: Okay, so I know your name may not be as familiar to many of the listeners so can you give us a little bit of a background about yourself and how you came to find out about peer-to-peer lending and Lending Club.

Scott: Yeah, so I have a background of marketing and technology. I was the Head of Worldwide Marketing of Pepsi and then headed some divisions at Microsoft with marketing for them. Came down to Silicone Valley and doing some startups in Silicone Valley and one of my startups was a jobs recruiting-oriented tech company and I was helping....in summer of 2007, helping Renaud Laplanche look for VPs of marketing. That's when I first came across Renaud in the very beginning.

Peter: How'd you meet him?

Scott: We had a mutual friend who made the introduction, knew the head of my company and he had a need so...

Peter: Okay, then so at that time was this pre-launch for Lending Club? Where were they at?

Scott: This was at the beginning when they did their first rollout on Facebook. You might know that history, but their very first effort was to get out on Facebook before they sort of evolved into the more classic web. Then I really got started on this whole space when I bumped into Renaud about a year later, September '08, and asked him how things were going. He showed me his business model and his business deck, more from a investor perspective and it was the kind of thing where I thought it was too good to be true so I studied the market, studied things all around credit and tried to understand why it could possibly make sense. In the fall of 2008, Lehman Brothers had gone down, the financial crisis was in full swing, Bernie Madoff was out there. The conventional wisdom was anything 10% is going to be risky. Prosper had been, for the most part, was getting a bad rep on the number of losses they were generating and so when all that was swirling as Renaud was trying to generate a little more investment in both the platform and in equity.

Peter: Right, so I guess back then the real challenge for Lending Club was the investor side of the business. They could find the borrowers, but getting people particularly and I imagine in the fall of 2008, getting people to come on board as an investor would have been a major challenge. By that stage, were you already an investor on the platform or did you basically....or did you start right around then?

Scott: I had, in summer 2007, a very small account, but I hadn't paid a lot of attention to it. I was mostly doing it out of curiosity then in ‘08 when I dug in deep with him and looked at the opportunityof investing more in both places, equity and platform, then that's when I dove in very deeply.

For me, there's three main points that I kept digging on which essentially defines the reason why the industry is interesting right. The one that I first became very surprised to learn is that the top credit-rated people rarely default even in recession. Their default rates...they'd rather do almost anything in the world possible to avoid a default, hence, the predictability of those returns and then understanding the difference between lending to a friend and lending to a bank because we are all raised being taught neither a borrower nor a lender be mainly because you borrow or lend to friends. When a friend borrows money from you, he thinks you have extra money that's why he asked you. When you lend him the money, you proved to him you did have extra money and then when he wants the money back, he wonders why you want it because it was extra. What's the big deal!

Peter: Right.

Scott: We know the opposite is that banks will ruin your life and your credit and make it very difficult to function in the world if you don't make your payments back. So that was the next big aha. The last one for me that really got me comfortable with the idea of investing with the idea of a back-up processors because Silicone Valley is notorious, of course, for start-ups to get going then don't make it and if in the middle of a three-year loan then what happens? So understanding that there is a whole industry of back-up processing for loan generation/loan generators is a pretty standard process was for me the three pieces that I thought were smart enough for me to get me to jump on the platform and on the equity side.

Peter: Right, so yeah, you became an investor back then. I mean, I actually want to....we were both at the New York Stock Exchange last week and heard Jeff Crowe talk about the dark days of 2008 when Renaud basically went along....obviously, Jeff Crowe of Norwest and Dan Ciporin of Canaan Partners were the two leads in the first Series A and basically, Lending Club had to go through this SEC registration which is extraordinarily expensive , which wasn't really planned and they were running out of money. I remember what Jeff Crowe was basically saying…. was that despite the fact, Renaud never wavered in his confidence and obviously, they decided to, basically, re-up and invest again. Was that the round that you invested equity in as well?

Scott: Yeah, I was alongside that round in October '08. The basic deal for me then was when I started putting my first million dollars on the platform. I was one of the first ones to put that kind of scale. I wasn't first because there's at least one other person, maybe two, ahead of me with that kind of scale, but going in with that scale, which is nothing now, of course, it was quite a bit. For me, I did that equity and the platform for two reasons and put my background was marketing. Renaud did not have a senior marketing person on the staff. We never were successful helping him find one in '07 so I just said...hey, I know how to grow your business. Here's a whole bunch of concepts that we can work on and if these make sense to you then I am in on both the equity and the platform. That then led me to come on as a contract person consultant. I came in the office every day, worked with a team, had my scott @ Lending Club.com e-mail and went to the whole song and dance of the different messaging referral programs and trying to understand what were those key factors people needed to know in order to be confident that they can invest in this crazy time period of 08/09 which felt risky in every way to people.

Peter: Right, so you came on board purely to try......you were focused on the investors' side instead of the borrowers' side, is that correct? Were you completely focused on the investors' side?

Scott: That was where my energy went. It wasn't as hard to find people who needed to borrow from the platform at that time. The biggest challenge, by far, at that time was getting investors on the platform. That was where all my energy went to and it was an interesting time period because this was so early in the age of peer-to-peer that the things we take for granted as obvious now weren't there.

For example, the most obvious one was diversification. Among the biggest problems that was happening to Lending Club as did Prosper was people would put a lot of money on one or two loans and one of them goes down, they lose a lot of money and there's no recovery. Anyway, as we looked at the statistics of it all, at least a hundred notes were really important, but ideally you would go to 350 or 400 and even better to a thousand, of course, if you run all the statistics on it.

So I talked to Renaud about these things that were seemingly essential to get lenders on board...look, we've got to figure out a way to tell people about the stability of the industry, about the nature of FICO scores and why top-rated credit people aren't that risky, about how to invest on the platform for diversification, how to understand what's happening on the platform when it comes to charge offs, a lot of people get on the platform...think they're going to earn 15% and they start to see charge offs and panic. All those sort of fundamentals were not communicated.

Peter: Right. As I mentioned in my introduction to the podcast, you created these webinars which...I went and watched I think all of them back in 2010 when I first started going and it was really the only educational piece that I could find online back then that showed investors really best practices on how to do this. It was a fantastic service so can you just tell us a little bit about the webinars and what their purpose was and how successful they were?

Scott: Yeah, Renaud was at a very tough time having finished his SEC approval now being allowed to bring on new investors. The rules were very tight, regulations were very tight around what he could and couldn't tell investors about how to work on his platform. He really believed that he was not able, on the Lending Club site, to give any kind of advice at all around diversification, what to expect or understanding why top credit-rated people aren't as risky as it might seem.

Because I wasn't an official employee of Lending Club, I volunteered to do this series which is essentially the result of all this analysis I was putting together to say...here are the fundamentals. So it was a combination of fundamentals of why the industry is okay and makes sense and then why or how to actually work best on the platform to minimize your risk. At that time, particularly, we talked about beating the average because the underwriting wasn't quite as polished as it is today where tricks people could do or techniques, tricks isn't the right word, but techniques and approaches people could use to just hedge the bet a little bit better.

So I volunteered to do these webinars and Patrick Gannon and I would set up every other month a different webinar. Patrick would ask questions, I would go through the PowerPoint and made sure it wasn't a Lending Club person giving any advice. I gave lots of advice so it was good fun.

Peter: So what were some of the things that you...I know it was a few years ago now, but, what were some of the things that you shared to investors back there about like best practices?

Scott: Well, in best practices on the platform, this was really simple stuff so it has to do with diversification and I tried to consumerize it so in the webinar, had little visuals which would show....if you had a 100 peas in a bowl and you picked five out, one of those five could be a bad pea, if you couldn't tell, but if had 100 peas in a bowl and there are only five bad ones in the bowl and you took all hundred peas then your chances of getting a bad loan essentially, be it the peas, are going to be statistically at the average by definition because that's what the statistics would show and that would be your ability to control and predict your returns by predicting your charge off rates. I had some very simple charts I went through page by page to help people understand what statistics means and why it makes sense for diversification. That, above everything, was the most important thing for people to understand.

Peter: That's still the most important thing.

Scott: Yeah, and then I went through...the other most common reason charge offs happened is unemployment and since I happened to come from the industry of jobs and job finding technologies, I understood that space pretty well so I had a fairly good vector on how do you look at someone's profile and bet on whether they're going to be a well-employed person or if they lose their job, how might they be re-employed so that was another key one.

The others ones I spent a lot of time on was the default curve because there's a dynamic on the platform we are all familiar now that we're participants in the space, but the first two or three months you think you're a genius investor because you're 13% notes are returning 13% and then by month five, six, seven, eight, nine, every month you're going down on a pretty steep slide and there's no way to know, if you're a consumer, that that slide is going to bottom out at 4/5% and hedge back to it by the time your loans mature you get your 9 or 10% return. There's no way to know that unless you are explained this dynamic of the default curve and the charge offs are virtually always accelerated into the first 12 to 15 months. I would spend a fair amount of time on that. It was important because at that time what was happening on the platform was right at that moment where someone let's say 4/6/8 months in should be recommending it to their friends, they were panicking and pulling money off the platform right at that same moment where they should be doubling down and quadrupling or quintupling whatever their total investment. They were just holding and then like wait and see. It really slowed the whole natural viral dynamic down a lot because of that uncertainty.

Peter: So how did these webinars go for Lending Club, did it help? Did it help attract investors?

Scott: Yeah, yeah, yeah, Lending Club actually asked me to keep doing them, that's one reason, but, no, we were measuring very carefully. They had a pretty solid team there, Rob Garcia on the products side and Soul Htite on the tech side, of course, the early guys, Sam Kastle was there, but everybody was curious to see what was happening from these. They were able to track who was on the webinar and then who went directly to the site and who would put money on. We've had this for many years. I think our highest one was 950 people per webinar so the attendance was good, the conversion was good and it was great. For most of 2009, every other month or so, we would put on a new one.

We did one, in particular, about IRAs which I still believe, anybody listening, your IRA should be on peer-to-peer, best possible place on the planet for an IRA. That compound interest is magic and then we did other ones that were focused on a kind of advanced investing and understanding the default curve, what do you do about it and how'd you manage that; depending on the different topics that were interesting and they were coming into Lending Club...I would design a webinar around that and then come into it.

Peter: Right, it's a shame those are not available anymore, I mean, they were. I actually didn't watch these webinars live. By the time I really got involved, they had been archived off, but they were still available on Lending Club's website. Over the course of a couple of days, several years ago, I was watching all of them and just thinking that was such a great resource and it's a shame they’ve been taken down now, but I think that the principles you talked about back in 2009 are still very much in play today.

I want to switch gears a little bit and talk about your fund because a lot of people think that LC Advisors was the first fund or Colchis was the first external fund in the space, but neither of these two entities were the first. Your fund was the first.

Scott: It's funny, I've been a little bit quiet on the background because I have private investors that fund us, we don't pitch for money and so I'm out sort of sending out all the marketing material, but as soon as I did my first webinar then Renaud started asking me in early 2009 to put a fund together, I thought, well, it would be quite a risk as the whole category wasn't even $100 Million. Anybody who starts a fund knows the fees were so small in something like this. You can actually get to some pretty significant scale in order to make it worthwhile to do a fund. But I decided to go ahead and do it at his request in order to just start putting down a track record because, you know, every friend I had in the finance world would say that when you get a three or four-year track record you're golden in the investment space. So I went through the whole RIA process, got the fund up and going in October 09, just a month or two before LC Advisors started, and for the first year or so the way that we were working with Lending Club was......I was doing a managed fund trying to optimize the return and LC Advisors was essentially doing their index on their main part and then they did an AB option on their fund as well after that came out.

So, yeah, between the money I initially put on the platform which I call my pre-fund investment to start the track record we have, five plus years of the full fund working on our track record and we have six years if you include the pre-fund money on starting in late ‘08. Yeah, that's been the longest running. When Colchis came out about a year, a year and a half after we did, some friends started showing me the marketing materials that they were seeing. Of course, they just started on Prosper, they weren't on Lending Club for quite a while actually, but, yeah, that's the timing on our fund.

Peter: So can you share the returns or any information about the fund for our listeners?

Scott: Oh, yeah, our core fund is very interesting because it's basically a 9.3% return to investors every year, year in year out, thru ‘09, ‘10, ’11, ’12. You know, 9.3 plus or minus 20 basis points or so, but not much fluctuation. It's been steady as a rock and so that part has been pretty fascinating to see in an outstanding, I think, counterpoint to all the naysayers who are talking and maybe less knowledgeably about the peer-to-peer space, about what a big risk it is for a downturn in the market to get into peer-to-peer. We saw zero hit to our returns to the entire worst part of the recession. That was partly because Renaud is adjusting interest rates up to compensate for a slightly higher charge off rate, but that was all managed pretty darn smoothly watching where the trends were going.

Peter: I know you don't do the day-to-day management for this fund, you have a fund manager. Are you still doing active...still cherry picking loans, how are you....has the investment strategy changed at all?

Scott: Well, we do....our investment management team is doing what everybody's doing now which is doing constant analysis on what's on the platform and all the data because the data transparency and tweak the models just a little bit, but for anybody who knows the credit team and the credit people at Lending Club, you know that there's a little bit of futility in all that analysis in looking for it because they're adjusting their own rates almost every quarter so no matter what you do, looking backward, you think you're applying it today. You're fooling yourself.

The other dynamic is that they're getting better and better at their own pricing. Of course, it's the nature of the business and as you and I have talked about the game in the space now, it's not really so much about how carefully do you pick the loan, but it's getting the right volume at the right grades.

Peter: Yeah, for sure, for sure. I want to now talk into the present and talking of what you're doing now, I know that you mentioned Soul Htite,,one of the very early people at Lending Club and he has since left Lending Club and is now creating a peer-to-peer lending company in China, the Dianrong or SinoLending, I know you were instrumental in helping that get off the ground, can you share what your relationship is with Soul and how and what you did to get that platform going?

Scott: No, it's a fun story. In those early days, there were 10 or 12 people in the office so we all got to know each other pretty well; John Donovan, Soul Htite, Howard Solovei and John Steward, Chris Young, that whole gang and so as Lending Club has been growing....you know, when I walk through the Lending Club hallways and know fewer and fewer people...one day I'm at Lending Club visiting, Soul in the hallway and says Scott, I've got something to show you. He reviews these ideas for starting a peer-to-peer in China, Lending Club China, and I thought, wow, this is completely crazy. If he's got enough guts to do it maybe I should get involved and so I helped him though his process of getting his business plan together and get his angel investment group together so I was his lead-angel on that and helped him get that first round of financing done. We worked pretty closely as far as.....as close as you can when he is in Shanghai and I am out here. I'm one of his board of directors and I spend a moderate amount of time just making sure that if I can help him however I can, he's pretty magical, but Dianrong as it's pronounced, or SinoLending as we've been referring to has just been stunning in its pace of growth, and the amount of traction it has right now getting top, top tier finance companies in China behind it and some really big marketers going down positioning Soul as on of the really fintech leaders of China.

Peter: Great, so beyond Dianyong you have your Incline fund. I believe there's a new Incline fund coming out. Is that the extent of your involvement in this industry today, I mean, are you working with any other platforms or what are you doing in the industry today?

Scott: Yeah, the fund that I'm.....I guess what I would call it, a significant owner in, and I call myself chairman because the investment team actually hired Howard Solovei, the first CFO of Lending Club, to run it so he's quite expert at everything related to this. We've launched the leveraged fund about a year ago and now rolling into other platforms beyond Lending Club so that group, the investment team, is managing well. There's this very interesting friendship of people that were in the early days at Lending Club including the early engineers, Visar Nimani, and a whole group of people Leonard and Paresh and the gang. This group is off thinking about what's next in their world, in their word of peer-to-peer, and so I can't reveal anything, but we are doing more angel investing and there are more things happening.

Peter: Right, Okay, so I can't let you go without talking about the IPO. We were both present at the New York Stock Exchange last week, Obviously, it's been...personally, financially for you it's been a huge success, you taking a punt back in '08 which seems obvious in hindsight, but I know at that time it must have been….it must have felt like it was....it was a bit of a gamble. Tell me your thoughts having watched this company now, really since its inception, what were your thoughts on IPO day last week?

Scott: IPO day was to me was two very clear thoughts. So there's a team of people in any start-up that need to work in a certain way of inventiveness and creativity to get it off the ground and get it going so the group that I was more connected to was that very early group. Just as we all know, once a company gets to be a certain size then there's a different kind of professional and more seasoned operating oriented large company skill set people. It was pretty fascinating just to sort of stand back and look at the team of the start-up guys who got it essentially to about a billion dollar valuation as that transitioned and rolled over to the team that took it the rest of the way. Shouldn't say a billion, Carrie and Scott, of course, were a big part, that's the company that hadn't nearly that valuation when Carrie and Scott got there so....but the transition, just the whole dynamic of watching the beauty of start-ups that evolve to larger operating organization and the IPO clearly all about the future. Here's a team that's going to take this thing from 8+ Billion market cap to, hopefully, 20,30,40 Billion.

Peter: So have you sold your shares? Are you still a Lending Club shareholder?

Scott: : I've sold a very few of my original shares. I'm a believer, I'm a believer in the next two to four years in particular. I think we're going to look back into two to four years and say, wow, it was so small and young back then. So I think there's a tremendous opportunity especially for Lending Club and a few others that have scale and have momentum.

Peter: Okay, so last question, where do you see the major opportunity for Lending Club over the next two to four years?

Scott: Well, that's really going to be a tricky one. The question's going to be how broadly can they go beyond the core that they have been in....straight unsecured loans or are they going to go into asset-backed lending or small business lending. Do they need to go into more spaces? It is really a big question. There's no right answer, I think. It could grow in any of those directions aggressively. I have no inside information, I'm not going to surprise anybody about these things, but my guess is that with that kind of cash in the bank, they might also be looking at acquisitions in order to help interest new spaces and gain the scale more quickly. So that's what I would be looking for.

Peter: Okay, well, on that note we'll have to close, but I certainly appreciate you coming on the show today, Scott. It was fascinating to hear what it was like back in those early days.

Scott: Thanks very much, Peter, it's been great talking to you.

Peter: Okay, see you.

Scott: Okay, take care.

Peter: You know, I can't imagine what it was like in making a decision to invest in Lending Club back in the dark days of 2008 when, you know, let's face it, we didn't know what was going to happen, was the entire banking system going to collapse, were we going to have another great Depression? We didn't know what was really going to happen. I think it was fascinating to find out some of Scott's thoughts from back then, about why he invested and the fact that he was willing to put a million dollars onto the platform to invest in loans, again not knowing...is unemployment going to go to 25%? We really didn't know that back then so I thought that was fascinating. And, now, even that was just over five years ago and we look forward to the next five years and certainly the opportunity is great for this industry.

On that note, I will sign off. I would like to wish you all Happy Holidays, Merry Christmas, enjoy your break and we will be back better than ever in the New Year. Thanks for listening. Bye.

[closing music]