Podcast Transcription Session 34: Michael Solomon

Peter Renton: Welcome the Lend Academy Podcast, session number 34. This is your host, Peter Renton, founder of Lend Academy.

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Peter: Today on the show, I am delighted to welcome someone who has been around this industry far longer than me and someone who was really around almost from the very beginning. Michael Solomon is the CEO and Co-Founder of CircleBack Lending, but CircleBack Lending was not his first go round in this industry and we're going to delve into that in this podcast. He certainly got some battle wounds, shall we say, from the early days that I think, as you'll see in the show, that's made this venture, CircleBack, a much more solid venture and he's started to enjoy some success so we will delve into that and much more in this episode. Hope you enjoy the show.

Peter: Welcome to the podcast, Michael.

Michael Solomon: Thank you, thanks for having me.

Peter: Okay, so let's get started....your background is a little bit different to everybody else that I speak to insofar as...you've been in this industry longer than I have. Can you just explain....I just want to find out a little bit about your background, what you did before you discovered peer-to-peer lending and then a little bit about what your first venture, what happened there and what that was about.

Michael: Sure, so back in 2007, when I had seen Prosper and Lending Club emerge, I thought it was a really, really clever concept and I was intrigued by the model. Prior to that or right around that time, I was both running a network of attorneys that provided legal and financial services to a host of different organizations, whether it was being the back office or behavioral health care consultant or serving three families with funeral homes across North America with estate planning.

At the same time, I was running a mixed immigration process that I built that got all these customers from online acquisition. I became very interested in online acquisition, you know, sort of the concept of lowering the playing field, lowering rates, providing better rates and quicker customer service was kind of something that I was used to from the days of my legal services operation and that was what it was all about. It was about disintermediation and lowering the cost of legal services. I thought this was interesting and decided to put my hat in the ring, so to speak.

I built a few websites and had a lot of knowledge about marketing, but really never embarked on touching ambitious projects like that and the company that was born, it was called Loanio. I spent the better part of two years spending all of the money that I had saved and leveraging my credit by hiring teams overseas that I then project managed here to build all the infrastructure and technology platform.

I guess within the year, it was in 2008, in the fall of 2008, I finally launched the platform and around the time that I launched was around the same time that the SEC had ruled against Prosper and decided to send them a cease and desist. As everybody knows and as the history goes because they did not agree that selling loans to people at $25 apiece would essentially......amounted to selling an unregistered security.

At that time we had to go dark as well and proceeded to then figure out what we were going to do and actually drafted our own S-1 registration statement which was what the SEC was requiring, but because it was the year 2008 and because....frankly, Lending Club and Prosper still hadn't proven their models out...really spending tens of millions of dollars, it became a very tough environment to raise outside operating capital.

Ultimately, at the end of the day, through subsequent amendments that we made with the SEC, I was forced to make a decision where either the next amendment would become our effective amendment to start operating again or I had to withdraw it. Because I was not able to raise more money and didn't want to do anything that would be grossly negligent and irresponsible, I had to drop the statement, move on to my other businesses and sort of put it on the shelf.

Peter: Right, so I think...I just want to be clear here, I mean, you basically drafted that S-1 by yourself....obviously, you're an attorney so you were able to use those skills to do that so you weren't hiring a law firm, right, to draft that S-1?

Michael: No, we didn't.....you know, the time really....was really operating the company with all of my own capital, we didn't have the money to go out and hire a wide shoe firm. Right after I launched the company, I brought on a guy by the name of Todd Walters who is now the COO of CircleBack and the two of us essentially locked ourselves in a room and more often than not, spent many hours at Panera Bread, it's a diner up in Rockton County, New York, just drafting this crazy document.

It certainly was a learning experience and it's kind of funny, at least I can put under my check boxes of accomplishments that I drafted an S-1 registration statement and it almost became effective. It was a daunting task, I mean, not only from just the disclosure side of it, but also the whole financial part of it because even though our financials were low at that time, we still had to go through the financial review as well. It was certainly a very good learning experience. You know, I think now if we had to do it again, obviously it would be easier for us to do it because we understand the mechanics of having to go through it.

Peter: Right, okay so you had unfortunate timing really. I mean, you had not just a Prosper cease and desist, you had the worst financial crisis in 75 years sort of unfolding as you're going through all this so.....it's interesting to me that you came back. I mean, you obviously....this was 2008. We first chatted in like 2011 when you were still....when Loanio.com was still an operational website. You obviously took some time, like you obviously went and did other things. What happened in the interim? So after 2008 you did your S-1, that was I guess 2009 and you decided to withdraw. What happened before you decided to go launch CircleBack?

Michael: Well, even after we withdrew the registration statement, I was still hopeful that I might raise more capital and things might turn around, but for quite a while I'd field a lot of calls where people would say, oh, yeah, I would want to give you money and yeah, we want to do business. They basically, mostly never lead anywhere.

I then got a call from a group about 2-1/2 years ago, 3 years from now, that they've made a lot of money in online lead generation and a lot of it was sort of in the near prime/sub-prime space. I guess they really saw the writing on the wall with the regulatory framework that we now find ourselves in and they were looking to diversify and said...hey, would you be interested in getting back involved in it.

Around the time that they were asking me was around the time when you finally started to see the movement, positive movement at Lending Club and Prosper in terms of signs of growth and profitability being around the corner with the large groups coming in to start purchasing loans that really helped to jog their businesses forward and I jumped at the opportunity to get back into it. I really felt I was cheated in a way like I didn't really get a fair chance to be a part of it. Obviously, I picked a lot of personal sacrifice, financial sacrifice, because I had spent really and leveraged myself really as far as you possibly could. It's almost like a movie.

Peter: Right, right.

Michael: So I was given the chance to do it, I jumped at the opportunity and so far, so good. We've come a long way and we have a long way to go, but I think that the environment, the economic climate is much better than it was the first time around.

Peter: For sure, for sure. So what do you think now that....what did you learn, you said it's your second rodeo and no one else in this industry has done this for the second time. How's it helped to have done this once before?

Michael: Well, I think that a lot of the time and I'm sure you could appreciate this, you know, really being an insider, that a lot of the times when you have discussions with folks that don't really understand what's going on with these businesses, is that they don't understand it, they don't understand really how sophisticated and complicated and complex the processes are, the regulatory framework are.

There's state and federal regulations, there's six different layers of regulatory agencies, the loan purchasers and balancing the mix of pricing and underwriting and portfolio management against the marketing needs and oftentimes these things conflict with each other and building out the technology, being able to responsibly scale in a way that makes sense and product.....it just goes on and on and on.

At the end of the day, the question is this...a financial institution or a financial company or a consumer finance company that's technology-enabled or is it a technology company that's doing consumer finance. It really is at its core, first and foremost, a consumer finance company because if you can't do those things properly the way that they need to be done then it doesn't matter how good your technology is.

Peter: Right.

Michael: So it's a little bit of everything, but looking from the outside it's easy to say....oh, let's take a few million dollars, get a couple of guys with MBAs from Stanford, throw them in a garage and we'll have a platform up and running and everything will be great. When people dig into it and I've seen it and I'm sure you've seen it too, a lot of folks coming and going, it's a lot more difficult than that. I think a lot of what I learned when I was with Loanio has certainly been very helpful in building this new business and making decisions properly and learning from mistakes that were made or at least understanding how to build a proper foundation to do this the right way instead of going off half cup....I'm not suggesting people are doing that but, you know.....(cross talking)

Peter: Yeah, I get an e-mail at least once a week, probably twice a week on average from new entrepreneurs who are thinking, how hard could it be, thinking about hiring a programmer, create a software online platform anywhere you go. As Ron Suber likes to say, this is a lot harder than it looks. I think you get to hit the nail on the head on it. If you don't have the risk, the underwriting piece down...consumer finance....I like the way to put that because it's really consumer finance is central. If you don't have the risk of this down, one, you won't be able to raise any money because no sophisticated investor is going to invest with you and if you are able to raise from unsophisticated investors, you're probably going to fail in the long term because the underwriting is the number one piece and I think that's great.

Michael: Just to add to that, it's more than just the underwriting. Everything that surrounds that is compliance.

Peter: Sure.

Michael: It's having somebody that understands compliance, it's the regulatory framework, it's auditing; every one of these little things. You're going out to institutions to put tens of millions of dollars on your platform, you better bet that they want all of these things in place and they want experienced people that know what they're doing because it's not kid's play and we're not making widgets here, this is serious business.

Peter: Right, right, okay, so let's move to present day. Can you just explain to the listeners what CircleBack does and how you're different to Lending Club and Prosper?

Michael: Sure, again and I guess part of it is just from experience, you know, taking the experience then leveraging it and then also just where we were in the marketplace when we started Loanio, but, sorry, when we started Loanio versus CircleBack Lending, but because there had been such a movement away from retail and more....the things that were driving the two other...what I like to call direct competitors because I think anybody that makes a loan in the competitor, but if we're going to say direct competitors like Lending Club and Prosper, we saw that there was a lot more institutional interest in coming to the platforms and at that time when we decided to take on the role of building out this new platform from scratch which we basically...I didn't pick anything from Loanio.

We made a deliberate decision not to enter the retail marketplace because we felt that it would just be easier for us to go the institutional route. It just seemed to make sense and we wanted the differentiators that we wanted to carve out. So we built the platform with the institutional investor in mind and then decided we were only going to sell whole loans to institutions.

One of the other things that became a differentiator, in addition to that, was not only were we going to sell loans to institutions, but, in the beginning at least, we were not going to cater to the groups that were geared up to do high frequency, kind of cherry picking trading as we like to call it. What I mean by that is as you know and I don't know, it sounds like this is dying a little bit on at least some of the other platforms, but there was sort of this cottage industry of funds that popped up who have their own underwriting teams and data analysts. They would come in to these other platforms and say...well, we figured out a better way to underwrite the underwriter so we found little pockets that we could exploit. For simplistic terms, people that have brown dogs are more likely to pay their loans so we're going to buy all the loans for people that have brown dogs. (laughs) That works to some level at a micro level, but you can't scale that way because even if you're lucky and you do find a pocket, once you start to scale, you have to expand the box that you're underwriting so it's not possible to do it that way.

Peter: Right.

Michael: But, more importantly, as our Chief Credit Officer, Alan Schiffres, likes to point out, if you use the analogy of playing with a deck of cards, it's like playing with a deck of cards, but you don't know what are some of the cards that have been removed. So there's 52 cards in the deck, I think, and if you have a deck of cards and you're playing cards but you don't know if the guys next to you removed half of the tens, the threes and the fours, it changes the probability, it changes cash flow, predictability, it makes the population of loans unstable because you don't know what everybody else is picking.

Peter: I just want to be clear about that. So, basically, when the investors sign up for CircleBack..I mean, obviously, they can give you, I presume, some sort of criteria that they're interested in or how does it actually work? Obviously, there's no cherry picking as you said, but.......

Michael: Right, now the way it's working, Peter, is that everybody that is buying from us is buying platform-wide and they've bought into our underwriting and pricing capabilities. What will happen as we continue to grow is that we may decide to let people, instead of cherry picking within each credit grade or segment, we may start to just sell certain segments....

Peter: That's what I was getting at.

Michael: So for argument's sake, let's say we have (inaudible) now, so at some point we might say...okay, you could just buy the B's through the A's because we're going to sell the A's to the people who really want the high quality, low risk paper. Right now, because of the way that our business model is built and our inability to take whatever institutions might not want and sell it in the retail marketplace because we don't have the retail component, it became necessary for us build the model that required everybody to buy platform-wide.

Obviously, all these different models present challenges. One of hardest things that we had to deal for a period about 12 months, about a year and a half ago, was send off and reject a lot of offers from funds that wanted to come in and cherry pick.

We could have very early on taken tens of millions of dollars from ....if we would have allowed that, but it didn't seem to make sense to us and wouldn't have worked very well with the business model and we held out. We're kind of glad that we did because I think what you're seeing now is that....well, at least what we're seeing is one of these groups that came to us and demanded that that's the only way they could work are now coming back and saying...hey, maybe you were right so now it's more about access so we have to go out and sell access to our limited partners and not the idea that we're going to get the extra hundred basis points because we're the smarter guys in the room.

Peter: Right, right.

Michael: It's an interesting shift and I think with that right....I mean, if we have lost that, but, you know......

Peter: Right, so you started looking at the beta program in the summer of 2013....There are articles on Lend Academy that follow the evolution of CircleBack then you raised an equity, but the big deal......I mean, you were going along for over a year and then you signed the $500 Million commitment from Jeffries which was obviously a huge game changer for you. So can you give us a little bit of an idea of what your loan volume was like up until September of last year and what's happened since then?

Michael: Sure, so prior to the announcement of the Jeffries deal, we had funded approximately $4.5 Million worth of loans during the twelve-month beta test and now it's mostly from friends and family and one or two small funds. After we announced the Jeffries deal, we really started the business once we had the capital to deploy in October of last year and today, we've been growing nicely month over month. I think we have about $71 Million of loans originated to date and next month we should do $18 to 20 Million so we are growing at a nice growth rate. It feels good and comfortable.

We haven't started to turn the dial-up yet, but we're getting to the point where we feel very confident that we could start to turn the dial-up and really increase the volume. If you look at the benchmarking of some of the other platforms and their origination growth, I don't think it's that much of a stretch to imagine that where we will be by the end of this year. We fully expect to be $75 to 100 Million a month by the end of the year.

Peter: Okay, that's some rapid growth right there. So are you looking for new investors now like as far as in the loans? Jeffries, obviously, has a big commitment, but if some of our listeners says...we want to invest this year, are you taking in new investors?

Michael: Well, yes, I mean, the short answer is yes. We always want to talk to investors and we are having discussions with many institutions right now. One of the things that happened was when we did the press release with Jeffries, some people got the wrong impression that Jeffries was going to take the first $500 Million of the entire platform and that wasn't really the way that we intended the deal to be structured.

The relationship has been great, they understand the need for us to diversify our sources of capital and want us to diversify our sources of capital because it just makes sense for everybody involved. We are talking to several institutions now, we expect we'll start on boarding those institutions over the next several months and continue to expand and diversify the platform as we grow.

With that said, we are looking for larger commitments and it just makes sense for us that from an efficiency and operating standpoint, in our opinion, it doesn't make sense to deal ....I'd rather deal with Can-Dive (?) that are giving us $10 to 20 Million a month than a hundred guys that are each giving us $1 Million a month.

Peter: Right.

Michael: So that's sort of fit the idea and seems to be working well. Anybody that is interested, certainly we're willing to talk and want to keep the dialogues going because things change on a weekly basis.

Peter Okay, so then which of the borrowers' side of the equation....like firstly, how many states are you open now for borrowers?

Michael: We are currently in 25 states and should be in another 20 states over the next 90 days.

Peter: Okay, wow, so you're really ramping that up.

Michael: Yeah.

Peter: What sort of criteria...do you have a minimum FICO, what kind of borrowers are you attracting?

Michael: Right now, the type of loan product that we have is similar to what you're seeing on the other platforms. It's early six months and 60 months installment loans.

We are cut off with FICO right now at 660, we're using TransUnion.

The types of folks that we're seeing and we're certainly running up against people that you're seeing...that are getting loans from another platform. It really just depends upon the channel that the borrowers are coming through and the go-to-market strategy really was to go out with something that we knew was working and seems to have a nice runway. As we scale and as we get our core competencies down, we'll start to go outside of that ring fence and start to expand and differentiate and really make changes that will be more distinctive.

Peter: Okay, so are you talking about going down the credit spectrum, the changes or are you talking about....what are you talking about? (laughs)

Michael: It could be a little bit of everything, right, it's just the way in which we're underwriting now. We're coming up on our first yearly vintage and wow that vintage was much smaller than the one we started in October. When we have enough data to really take a look at things, we'll start to be able to make changes. We haven't really made changes to our credit policy yet just because we haven't gathered enough data. So that will give us the opportunity to look at other credit segments, that will give us the opportunity to look at other traps of the market to determine whether or not we make more dramatic changes from where we started which was to have more of a plain vanilla flavor.

We'll certainly be looking at other asset classes as others have and have a few in our minds. There are a couple of other ideas for features or benefits that we might want to add on to our unsecured products that you're not seeing on the marketplace and sort of to give you a sort of foreshadowing or a hint. One or two of those things may have been a part of the Loanio days.

You never know, but the exciting part is there is a lot of runway here and there's a lot of opportunity and a lot of people that are in the credit space. Different segments have different needs and ultimately, it's about executing well and being able to be good at segmenting markets and understanding the various segments of the market.

Peter: Right, right. How do you feel.....I mean, you talked several times....you mentioned that there's a lot of runway and you scaled from a pretty low level to $20 Million a month, you're talking about $100 Million a month, how do you feel about borrower position? Do you feel you can still get economies of scale as you grow? I know you're not going to give away any secrets, but I just wanted to think about....... I want to get some sense of how you think about borrower acquisition on the different channels and how much runway there is in each of these channels.

Michael: Right, so clearly there's a lot more competition today than there was three/four years ago. That's why I mentioned, I think, that it becomes even more important to be able to execute your marketing plans well and being able to segment the marketplace and understand each of those market segments and give people what they want. It all comes down to having a good understanding of the balance between origination, marketing and credit and what's the right mix and what's the right pricing. While many of the markets are very sensitive to price, it's not always all about price. There are other value propositions that drive other types of borrowers so it's about figuring all that out and doing it really well.

I think that from a runway perspective, by no means is any of these easy. I think that we've spent a long time and obviously even from my Loanio days in understanding how to acquire a customer and how to acquire a borrower and what moves a borrower. I think that it's certainly not easy, but I think that we've figured out the formula to some extent and that's half of the battle.

Many people would determine the organizations that spend tens of millions of dollars clearing out the formula and that was one of the benefits when we talked earlier today about what did I learn from Loanio, what did we do at Loanio. Well, I still like to talk about the third, fourth move advantage because we were able to do all that stuff and arguably, takes five months of real operations and move the needle much further or to get to the point of $20 Million then maybe it took some of the others several years to get there.

Peter: Right, right, fair enough. So can you at least comment....is direct mail the major part of your operation or is online lead generation or where does it fit?

Michael: Yeah, well, what I can tell you is that the majority of our buying has come from online channels, thus far, and as we grow, we recognize that direct mail will become a component of the marketing mix and we'll start doing that, but like every other channel it takes a lot of hard work and money and smarts and analysis in market segmentation in order to get it right. We think that online, offline, all those channels play an important role in the overall customer acquisition.

Peter: Right, so what would you say then is your biggest challenge today? You've got a platform that's clearly no longer just a start-up, but you're not of the scale of Prosper or Lending Club, so what is your big challenge to try and get up to the next level?

Michael: Well I think it has a lot to do with the way that we're marketing, also having more capital and having the right people on the team. I think we've done a good job of building out a team.

In growing this business, the first thing I had to understand or at least a good CEO has to understand is where do they not have strengths and where you have to bring people in that are smart and know what they're doing in all of these various areas. When we started this business, I really had no credit underwriting background so the obvious thing to do was to first go out and find a chief credit officer, along the way bring in folks in respective areas that could really bring value to the organization as a whole. Now that we've really gotten things working well with our loan analysts and our call center, the operations....we're at about 55 heads today.

Now the next challenge is to start dialing-up and trusting that this could be how scalable it is. Along the way we expected we will have mistakes we'll make and things that we're doing will happen will probably we're not operating enough, but doing things the right way because you have to do things the wrong way at some point.

The challenges really are just getting out there telling and executing the marketing properly so that we could better understand the consumer segments and then also start to differentiate. I think by the time we get to $100 Million a month we'll start changing our focus from customer acquisition and sales to branding and really who is CircleBack and how are things unfolding.

One of the challenges will be as we get the folks in the road and as we decide what's our next move, what's our next product, who are we, where are we going next, those will be the challenges, trying to make those decisions and sleeping at night to make sure we made the right decision. Of course, it's in the back of our minds that always have us fearful is fraud prevention because fraud is something that's a moving target. At the end of the day, when you get hit with fraud that could really create some serious damage to the company.

Peter: Right, right. Okay, one last question before I let you go. You, obviously have thought about this and I'm sure you've given presentations about this, where is CircleBack, what's your vision for CircleBack in the long term? Are your comfortable being a number three or four player here? Do you feel like one day you're going to be bigger than Lending Club? What is the vision for the long term?

Michael: Right, so people ask that a lot and I think that in the world of consumer finance where you have Bank of America co-existing with Chase and Citigroup and 6,000 credit unions, 6,000 community banks and all these other players, we're happy to be in the third or fourth slot and we don't wake up every morning thinking how can we beat Lending Club or how can we beat Prosper, how can we be number one.

I don't believe that the zero sum sort of network effect play for many reasons. You don't see that in the brick and mortar side of the equation either so for us, I think the goal is to just build the sustainable organization, build the brand, build something recognizable and build something we could be proud of. When consumers think of us, we want them to think of good experiences, we want them to think of quick service, reasonable rates, affordable rates and that goes a long way.

Our goal is to, obviously, scale up to origination in the hundreds of millions of dollars and be somewhere that you see Lending Club and Prosper today, but I also like to say that if we got to that level and never grew anymore than that, I don't think any of my stakeholders would go home and be upset. I think they'd be quite happy achieving that level of success.

I still think we have a long way to go, but we're certainly on the right path and I think we have a good foundation and solid base (inaudible). That's what makes it exciting and it's the getting up everyday and coming into office keeps me going.

Peter: Right, right. Well on that note I think we should end it, but I certainly wish you all the best, Michael. I don't think anyone in this industry deserves success more than you. You've really put in some hard yards over the years and great to see you're on your way again now.

Michael: I appreciate it, Peter, and look forward to seeing you in a few weeks in New York.

Peter: Okay, at LendIt, yes, indeed. Okay, thanks for your time today, Michael.

Michael: Right, thank you.

Peter: Okay, see you.

You know, Michael brings up an interesting question there at the end as to really how many online platforms can this industry sustain. Now, it's certainly not going to be a winner take all, I think we have established that now, but how many platforms, I think, is going to be dependent upon how successful this industry is in attracting borrowers in the long term and how it scales.

Obviously, there's a lot of people who believe, including myself, that we have got a lot of runway left and we're going to keep doubling the size of this industry every year for many, many years to come. So you think about that then you think there could easily be five, ten, fifteen and potentially twenty. I mean, I don't know if there is going to be thousands like there is in the banking system, but certainly I could see fifteen to twenty successful platforms in the consumer lending space alone and I think CircleBack has a great shot at being one of those companies that are successful in the long run.

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

[closing music]